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US ENERGY CORP
Form 10-K/A
January 13, 2003

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K/A
AMENDMENT NO. 3

MARKED FOR
CHANGES

(Mark One)

- Annual report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended May 31, 2001 or
 - Transition report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from _____ to _____
- Commission file number 0-6814

U.S. ENERGY CORP.

(Exact Name of Registrant as Specified in its Charter)

Wyoming

83-0205516

(State or other jurisdiction of
incorporation or organization)

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

877 North 8th West
Riverton, WY

82501

(Address of principal executive offices)

(Zip Code)

Registrant's Telephone Number, including area code: (307) 856-9271

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

NONE

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

COMMON STOCK, \$0.01 PAR VALUE

(Title of Class)

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

The aggregate market value of the shares of voting stock held by non-affiliates of the Registrant as of August 17, 2001, computed by reference to the average of the bid and asked prices of the Registrant's common stock as reported by the National Market System of NASDAQ on that date, was approximately \$30,467,400.

Class

Outstanding at August 17, 2001

Common Stock, \$0.01 par value

9,609,104 shares

Documents incorporated by reference: Portions of the documents listed below have been incorporated by reference into the indicated parts of this report as

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specified in the responses to the referenced sections of this filing.

Annual Meeting Proxy Statement for the fiscal year ended May 31, 2001 into Part III of the filing.

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

DISCLOSURE REGARDING FORWARD LOOKING STATEMENTS

This Annual Report on Form 10-K includes "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). All statements other than statements of historical fact included in this Report, are forward-looking statements, including without limitation the statements under Management's Discussion and Analysis of Financial Condition and Results of Operations and the disclosures about Rocky Mountain Gas, Inc. and plans for developing its coalbed methane acreage. In addition, whenever words like "expect," "anticipate" or "believe" are used, we are making forward-looking statements.

Although we believe that our forward-looking statements are reasonable, we don't know if our expectations will prove to be correct. Important future factors that could cause actual results to differ materially from expectations include: Domestic consumption rates for natural gas; domestic market prices for natural gas, uranium, gold, and molybdenum; the amounts of gas we will be able to produce from our coalbed methane properties; the availability of permits to drill and operate coalbed methane wells; whether and when gas transmission lines will be built to reasonable proximity to our coalbed methane properties; and whether and on what terms the capital necessary to develop our properties can be obtained. The forward-looking statements should be carefully considered in the context of all the information set forth in this Annual Report.

PART I

ITEM 1 AND ITEM 2. BUSINESS AND PROPERTIES.

(A) GENERAL.

U.S. Energy Corp. is a Wyoming corporation (formed in 1966) in the business of acquiring, exploring, developing and/or selling or leasing mineral properties, and the mining and marketing of minerals. In this Annual Report, "we", "Company" or "USE" refers to U.S. Energy Corp. including subsidiaries unless otherwise specifically noted.

In fiscal 2001, we were engaged in three industry segments: exploration of coalbed methane properties (and holding inactive mining properties); motel, real estate and airport operations; and contract drilling/construction operations. In the first segment, we have three principal mineral sectors: coalbed methane gas, uranium and gold (properties and other assets included in the latter two sectors are shut down). The uranium properties are located on Sheep Mountain in Wyoming, and in southeast Utah; we also hold a royalty interest in uranium claims on

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Green Mountain, Wyoming, now held by Kennecott Uranium Company (see below). The gold property is located in Sutter Creek, California, east of Sacramento. Interests are held in other mineral properties (principally molybdenum), but are either non-operating interests or undeveloped claims. We also operate a small oil field in Montana. Our fiscal year ends May 31.

The activities on the coalbed methane gas properties are conducted through Rocky Mountain Gas, Inc ("RMG," a Wyoming corporation owned 42% by USE and 42% by Crested Corp.; Crested is a 70.5% majority-owned subsidiary of USE, see below). Properties of RMG are held in Wyoming and southeastern Montana. As of the filing date of this Annual Report, RMG holds approximately 257,000 gross mineral acres of coalbed methane properties.

We have conducted exploratory drilling and testing on certain of the coalbed methane properties, but in general, additional work (gathering production data from a producing property, and on other properties, the dewatering of completed wells, and drilling and dewatering more wells) will have to occur to establish if we have any proved reserves. Specifically, we expect to make a determination whether there are proved reserves on our producing property (Bobcat property) by February 14, 2003, and on another property (Clearmont,

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which is not now in production) by April 30, 2003. We did not receive any revenues from coalbed methane gas sales through the end of the most recent fiscal year (May 31, 2001), although after that date, we have been selling coalbed methane gas from the producing Bobcat property (bought in June 2002).

For detailed information about our coalbed methane properties and business strategy, please see "Minerals - Coalbed Methane" below.

We don't know if anything of value will result from our activities in the coalbed methane area: Only a limited number of exploratory wells have been drilled, and there is not yet enough information from these wells to determine if they contain proved reserves; gas prices are low in the Powder River Basin (our area of activity), and continued low prices will affect not only the economics of the producing Bobcat property, but also the economics of the exploration projects as they move into production in the future. In addition, delays in obtaining permits needed for continued exploration could delay our coalbed gas plans, and more funding may be needed but may not be available.

USE and Crested Corp. ("Crested") originally were independent companies, with two common affiliates (John L. Larsen and Max T. Evans; Mr. Evans is now deceased). In 1980, USE and Crested formed a joint venture ("USECC") to do business together (unless one or the other elected not to pursue an individual project). As a result of USE funding certain of Crested's obligations from time to time (due to Crested's lack of cash on hand), and Crested subsequently paying these debts by issuing common stock to USE, Crested became a majority-owned subsidiary of USE in fiscal 1993. In fiscal 2001, Crested issued another 6,666,666 shares of its common stock to reduce Crested's debt owed to USE by \$3.0 million, which increased USE's ownership of Crested to 70.5%. All of USE's (and Crested's) operations are in the United States. Principal executive offices are located in the Glen L. Larsen building at 877 North 8th Street West, Riverton, Wyoming 82501, telephone 307.856.9271.

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Most of the Company's (USE's) operations are conducted through subsidiaries, the USECC joint venture with Crested, and jointly-owned subsidiaries of USE and Crested.

The Company's subsidiaries are:

| Subsidiary ----- | Percent Owned by USE* ----- | Primary Business Conducted ----- |
|----------------------------|-----------------------------------|---|
| Plateau Resources, Ltd. | 100.0% | Uranium (Utah) - Inactive - shut down; Motel/real estate - Active |
| Energx, Ltd. | 90.0% | Gas - Inactive - shut down |
| Four Nines Gold, Inc. | 50.9% | Contract Drilling/Construction - Inactive (since 2001) |
| Sutter Gold Mining Company | 66.3% | Gold (California) - Inactive - shut down |
| Crested Corp. | 70.5% | Uranium, gold and molybdenum properties (all inactive and shut down), and explo activities on coalbed methane propertie |
| Yellowstone Fuels Corp. | 35.9% | Uranium (Wyoming) - Inactive - shut down |
| Rocky Mountain Gas, Inc. | 84.0% | Coalbed methane exploration |
| Northwest Gold, Inc. | 96.0% | Gold (Montana) - Inactive - shut down |
| USECC Joint Venture | 50.0% | Uranium (Wyoming, Utah), gold and molybdenum,** all inactive and shut down and coalbed methane exploration |

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*Includes ownership of Crested Corp. in RMG and Sutter.

**There are no plans to put the molybdenum property into production in the foreseeable future. See "Inactive Mining Properties - Molybdenum.

Until September 11, 2000, USE, USECC and Kennecott Uranium Company ("Kennecott") owned the Green Mountain Mining Venture ("GMMV"), which held a large uranium deposit and uranium mill in Wyoming. On September 11, 2000, USE and Crested settled litigation with Kennecott involving the GMMV by selling their interest in the GMMV and its properties back to Kennecott for \$3,250,000 and receiving a royalty interest in the uranium properties. The GMMV properties are shut down. Kennecott also assumed all reclamation obligations on the GMMV properties; reclamation obligations for an ion exchange facility located on properties outside the GMMV were not assumed by Kennecott, see "Sheep Mountain Partners - Properties" below. Other uranium properties and a uranium mill in southeast Utah are held by Plateau Resources Ltd., a wholly-owned subsidiary of USE. The Utah uranium properties are shut down.

The mineral properties held by Sutter Gold Mining Company ("SGMC"), a majority-owned subsidiary of USE, are shut down because the current price of gold does not permit raising the capital necessary to put the properties into

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production.

(B) FINANCIAL INFORMATION ABOUT INDUSTRY SEGMENTS.

During the three fiscal years ended May 31, 2001, for technical financial presentation purposes, we operated in three business segments: (i) coalbed methane gas exploration (and holding shut down mines and mineral properties), (ii) motel, real estate, and airport operations, and (iii) contract drilling/construction (principally in fiscal 2000 and the first quarter of fiscal 2001). The principal products of the operating units within each of the reportable industry segments for the three fiscal years ended May 31, 2001 are set forth in the table below.

While we technically had three segments in this three year period, most of our activities in minerals, motel/real estate/airport, and contract drilling/construction have ceased or have been severely curtailed. The only current activities of a material and recurring nature are in coalbed methane, and motel operations and management services.

INDUSTRY SEGMENTS

PRINCIPAL PRODUCTS

Coalbed Methane Gas Exploration
(and holding of mining properties
which are shut down)

Acquisition of coalbed methane properties, and exploration and development of such properties for coalbed methane gas. This activity is material and recurring, and is our principal business focus. Sales and leases of mineral-bearing properties and, from time to time, the production and/or marketing of uranium, gold and receipt of advance royalties on molybdenum. Activities in uranium, gold and molybdenum are shut down as recurring activities.

Motel, Real Estate and
Airport Operations

Operation of a motel and rental of real estate, operation of an aircraft fixed base operation (fuel sales, flight instruction and aircraft maintenance), and various contract services, including managerial services for subsidiary companies. Only the motel and real estate, and management services activities remain active now. Though significant in terms of contributions to revenues on a

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historical basis, these operations are auxiliary to the principal business focus of the company (coalbed methane).

Contract Drilling/Construction

Contract drilling of coalbed methane gas wells, construction of drill sites, gas pipe lines, reservoirs and reclamation of locations. This activity has been shut down.

Percentage of Net Revenue contributions by the three segments (and by interest on cash accounts) in the last three fiscal years were:

| | Percentage of Net Revenues During the Year Ended | | |
|--|--|--------------------------|--------------------------|
| | May 31, 2001 ----- | May 31, 2000 ----- | May 31, 1999 ----- |
| Coalbed Methane (and shut down mining properties) | 3% | 2% | 2% |
| Motel, Real Estate and Airport Operations | 15% | 36% | 27% |
| Construction Operations | 15% | 46% | 0% |
| Interest and Other | 67% | 16% | 71% |

In fiscal 2001, we received \$442,800 in revenues from the coalbed methane and mining properties segment, as compared to \$132,600 in fiscal 2000; none of the revenues were from coalbed methane gas sales. During fiscal 2001, there were \$108,500 from molybdenum advance royalties, and \$334,300 from uranium contract deliveries and the sale of a uranium delivery contract. During fiscal 2000 we recorded \$132,600 from advance molybdenum royalties. During fiscal 1999, there were revenues of \$150,600 from molybdenum advance royalties and \$87,600 for uranium contract deliveries. We have not received revenues from coalbed methane/mining properties activities, other than the preceding transactions in fiscal 2000 or 2001, as our mineral properties are either shut down (our uranium and the Sutter California properties, and the molybdenum property which is held by another company), or in exploration (our coalbed methane properties).

Motel, real estate and airport operations during fiscal 2001 generated revenues of \$2,222,400, compared to \$2,734,800 during fiscal 2000, with the decrease due to a slower tourist season at the motel operation in southern Utah.

Contract drilling and construction operations for third parties in the coalbed methane business resulted in revenues of \$2,238,600 during fiscal 2001 compared to \$3,584,900 during fiscal 2000. No revenues were recognized in this segment in fiscal 1999. After May 31, 2001, these third-party services were shut down.

In coalbed methane, we compete against many companies, some of which are much larger and better financed than the Company. The principal area of

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competition is encountered in the financial ability to acquire good acreage positions and drill wells to explore coalbed methane potential, then, if warranted, drill production wells and install production equipment (gathering systems, compressors, etc.).

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We own a royalty interest in a molybdenum property in Colorado; the property is owned by Phelps- Dodge, a worldwide integrated minerals company with inventories of exploration, development stage, and producing properties, involving numerous metals and other minerals. We believe that at the present time, Phelps Dodge does not have a plan to place the molybdenum property into production.

In the motel, real estate and airport operations segment we own and manage an office building (where our headquarters are located), a fixed based aircraft operation, and small parcels of land, all in Riverton, Wyoming and a small amount of additional acreage elsewhere in Wyoming. We also own townsites, a motel and convenience store, and other commercial facilities in Utah. There is no significant competition in this area ; although parcels are sold from time to time, we are not in the land development business. In fiscal 2001, we reported revenues from contract methane well drilling and support services. We have sold off most of the equipment used in these operations in fiscal 2002, retaining three drilling rigs for RMG operations as needed. As of the date of this amended report, construction activities are limited to a few small projects in Riverton, Wyoming. We contract out RMG's coalbed drilling and construction work to third parties.

(C) NARRATIVE DESCRIPTION OF BUSINESS BY INDUSTRY SEGMENT (INCLUDING ITEM 2 - PROPERTIES).

Coalbed Methane (and Inactive Mining Properties)

COALBED METHANE

GENERAL. Rocky Mountain Gas, Inc. ("RMG") was incorporated in Wyoming on November 1, 1999 for business in the coalbed methane industry in Wyoming and Montana. RMG is a subsidiary of the Company (owned 42% by the Company and 42% by Crested), as of May 31, 2001.

At September 25, 2002 RMG holds leases and options on approximately 277,586 gross acres of federal, state and private (fee) land in the Powder River Basin of Wyoming and Montana. Most of this acreage was acquired in the fiscal year ended May 31, 2001. As of September 25, 2002 there are no producing CBM wells on any of the acreage. Not included in this acreage total is the 1,940 gross acres in the Bobcat Property, a producing CBM property acquired by RMG in June 2002.

Through May 2002, 58 CBM wells have been drilled, almost all with funds provided by industry partners CCBM, Inc. and SENGAI (see below). Reserves have not been established for any of the properties on which wells have been drilled.

Independent reserve evaluations will be conducted and reported by February 14, 2003 for the Bobcat property (bought as a producing property in June 2002), and by April 30, 2003 for the Clearmont prospect (undrilled acreage acquired in fiscal 2001, drilling started in fiscal 2002). In the case of the Bobcat property, reliable daily production data is being obtained (well gas pressure, water production, etc.) to provide the necessary data base for a reserve evaluation. For the Clearmont property, the current dewatering process should be completed and initial gas sales commence in early 2003, which will provide the necessary data base for a reserve evaluation of that property.

In summary, the valuation process for the investments in Bobcat will be completed by February 14, 2003, and for Clearmont by April 30, 2003. See "Acquisition and Exploration Capital Expenditures" below. The valuation will be made when there is enough information to do so. If production has not reached levels that are economic at the gas prices on evaluation date, there would be no proved reserves on the subject property.

We have not established that our investments in coalbed methane properties and exploration activities will yield anything of value. We will not be able to make that assessment until the presence, or absence, of reserves on the properties is established. The first properties to be evaluated will be Bobcat and Clearmont. Other properties (especially Castle Rock and Kirby) are very large and will require the drilling of numerous exploratory wells and extended dewatering periods for each group or "pod" of wells (from 6 to 18 months after drilling and completion) before an assessment of reserves can be made. In some areas where no other coalbed methane wells on adjacent properties are dewatering the coal seam, the dewatering process could take as long as 24 months.

Among the uncertainties we face in the process of determining if our coalbed methane investments will yield value are the following: Prices for gas sold in the Powder River Basin are the lowest in the United States and may not improve enough, over a sustained time period, to make many properties economic; capital (in addition to the \$2,245,000 at May 31, 2002 remaining from CCBM, Inc.'s drilling fund) to continue exploration efforts may be needed but not available; and permitting issues may delay further work. An unfavorable confluence of these uncertainties, if realized, could result in a write-down of the carrying value of properties which don't produce enough gas at low prices to be economic; the write-down of the carrying value of other properties which need more wells drilled and dewatered to improve the economics of production (but the capital isn't available); and/or the delay (whether from lack of capital or permitting problems) in establishing reserves for the larger prospects where many wells will have to be drilled to assess to value of the properties.

ACQUISITION AND EXPLORATION CAPITAL EXPENDITURES

From inception on November 1, 1999 through May 31, 2001, RMG incurred total acquisition (purchase price and holding costs) and exploration costs (drilling and completion) on coalbed methane properties of approximately \$5,881,700.

The following table shows certain information regarding the gross costs

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incurred.

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| | Year Ended May 31, | |
|-------------------|--------------------|--------------|
| | 2001 | 2000 |
| Acquisition costs | \$ 870,600 | \$ 4,727,200 |
| Exploration | 283,900 | -- |
| | \$ 1,154,500 | \$ 4,727,200 |

Acquisition costs included amounts paid for properties , delay rentals, lease option payments, and general and administrative costs directly attributable to the acquisitions.

The recorded amounts for acquisition and exploration of \$5,881,700 and \$4,727,200, represent 19.3% and 15.3% of total assets at May 31, 2001 and 2000.

We use the full-cost method of accounting for gas properties. Under this method, all acquisition and exploration costs are capitalized in a "full-cost pool" as incurred. Depletion of the pool will be recorded using the unit-of-production method. To the extent that such capitalized costs in the full-cost pool (net of depreciation, depletion and amortization and related deferred taxes) exceed the present value (using a 10% discount rate) of estimated future net after-tax cash flows from proved gas reserves (which will be established by the reserve reports to be obtained by the company), the excess costs will be charged to operations.

If it is determined that there are no reserves on the Bobcat or Clearmont properties, all acquisition and exploration costs previously capitalized for those properties will be written-down and charged to operations. To the extent reserves are established to be less than such costs, the costs will be written-down to the amount of present value of the reserves. In this event, assets would decrease and expenses would increase. Once incurred, a write-down of gas properties can't later be reversed.

In addition, if at some point in the future the exploration work on our other prospects (in particular the larger prospects) would be delayed because of lack of capital or permitting delays, or both, with the result that it cannot be established whether or not proved reserves exist on the properties, the exploration costs for those properties would be written-off.

When reserve reports are obtained on our properties, any resulting impact on the financial statements will be reported in the next periodic filing with the SEC.

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OVERVIEW OF RMG. All of the information about Rocky Mountain Gas, Inc. which follows is as of the filing date of this amended Annual Report, unless otherwise stated. We hold leases and options to develop approximately 277,586 gross mineral acres (including 43,711 acres we have options on) under leases from the United States Bureau of Land Management, the states of Wyoming and Montana, and private landowners. Table 1 shows the total gross and net lease acres held in each prospect, and the amount of such acreage held by RMG and by companies with which RMG has agreements for holding, acquiring and/or drilling the prospects (CCBM, Inc. and Quaneco, L.L.C.). These agreements are summarized under "Carrizo - Purchase and Sale Agreement" and "Quaneco - Agreement." Acreage data assumes CCBM completes its purchase of an undivided 50% working interest in the Kirby, Oyster Ridge, Clearmont, Sussex, Finley, Baggs North and Gillette North prospects. CCBM will own its 50% working interest in wells drilled under CCBM's drilling fund commitment, but if CCBM does not complete its purchase obligations, CCBM would not be entitled to a working interest in the remaining undrilled acreage.

CCBM currently has purchase rights to acquire a 6.25% working interest in the Castle Rock prospect, and owns a 6.25% working interest in eight wells in Castle Rock, which were drilled by Suncor Energy Natural Gas America, Inc. ("SENGAI"). RMG's and CCBM's interests in the Castle Rock prospect, as shown in Table 1, reflect the completion of SENGAI's drilling program in late calendar 2001. SENGAI elected not to exercise its option on February 8, 2002. See the summary below, and "SENGAI - Option and Farmin Agreement."

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RMG's staff includes a professional geologist, a landman, and field supervisory personnel. Prospects are evaluated for coal potential using available public and industry data, taking into account proximity to other positions held by RMG and existing or planned gas transmission lines, and whether drilling and production permits can be obtained and the costs thereof. The final decision to acquire a prospect is made by the president of RMG. Well drilling and testing is done by outside contract drilling companies. Drilling results (cores, gas and water flow rates, and other data) are evaluated by RMG staff, using customary technical methods, to determine if any zones encountered in the well should be completed for production. Completion requires setting casing pipe down to the zone(s), installing pumps, and installing and setting up the necessary surface equipment (for example, water disposal lines and water holding tanks for evaluation wells in Montana, pending production permitting approval and water holding ponds in Wyoming). The decision whether to complete the well is made by RMG's president.

Table 1 reflects RMG's acreage position as of April 30, 2002 and does not reflect the acreage we own in the Bobcat prospect. See "Bobcat Property." Also, Table 1 does not reflect the reduction in net acreage held by RMG if Anadarko Petroleum, Inc. exercises its option to back in for a 25% working interest on 43,711 gross acres within the Oyster Ridge prospect. Also, 43,711 of the acres shown as held in Oyster Ridge, assume we continue to earn acreage under the drill-to-earn-acreage provisions of the option agreement with Anadarko. See "Description of Prospects - Oyster Ridge" below.

TABLE 1

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ROCKY MOUNTAIN GAS, INC.
ACREAGE HELD

| Project and Date Acquired | Gross Lease Acres | Net Lease Acres | RMG Net Acres | Quaneco Net Acres | CCB Ac |
|-----------------------------|-------------------|-----------------|---------------|-------------------|--------|
| Castle Rock Jan. 2000 | 123,840 | 111,567 | 48,811 | 55,784 | 6, |
| Kirby Jan. 2000 | 80,254 | 74,512 | 18,628 | 37,256 | 18 |
| *Oyster Ridge Dec. 1999 | 65,247 | 65,247 | 25,729 | 0 | 25 |
| Clearmont Jan. 2000 | 5,345 | 2,785 | 1,393 | 0 | 1, |
| Sussex Jan. 2000 | 640 | 640 | 320 | 0 | 3 |
| Finley Jan. 2000 | 160 | 160 | 80 | 0 | |
| Baggs North Jan. 2000 | 120 | 120 | 60 | 0 | |
| Gillette North Jan. 2000 | 80 | 80 | 40 | 0 | |
| Arvada Jan. 2000 | 1,900 | 1,700 | 850 | 0 | 8 |
| TOTAL | 277,586 | 256,811 | 95,911 | 93,040 | 54 |

We own a 25% working interest (20% net revenue interest) on 80,254 gross and 74,512 net acres in the Kirby prospect (southeast Montana) and a 50% working interest (from 30% to 50% net revenue interest) on 73,492 net acres in other prospects (all in Wyoming). We own a 43.75% working interest (35% net revenue

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interest) in the Castle Rock prospect on 123,840 gross and 111,567 net acres in southeast Montana. CCBM, Inc., a subsidiary of Carrizo Oil and Gas, Inc., can purchase a 6.25% working interest in our acreage (6,973 net acres) of the Castle Rock prospect if they meet certain payment obligations. In July 2001, we sold a 50% working interest in all our coalbed methane leases, except at Castle Rock, to CCBM for \$7,500,000, plus other considerations.

CCBM will pay for up to \$5,000,000 of drilling and completing coalbed methane wells on the properties owned by RMG and CCBM. Drilling started on the Clearmont prospect in Wyoming in August 2001. This drilling program should be sufficient to drill approximately 60 coalbed methane wells to completion or abandonment stage. We have a carried working interest in all of the wells drilled in these programs.

As of April 30, 2002, we had set casing on 22 wells (80 acre spacing units) at the Clearmont prospect and are now in the process of drilling six additional wells. No reserves have been established to date. Drilling permits for 58 additional wells have been issued for the Clearmont prospect.

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A total of 58 wells have been drilled on RMG acreage to date: five in fiscal 2001 and 53 in fiscal 2002. Nineteen of the wells were drilled by SENGAI in Castle Rock under the terms of the Suncor Option and Farmin Agreement (see below). Eleven of those 19 wells were stratigraphic wells and will be reclaimed by Suncor. Eight of those 19 wells were completed and are owned by RMG (93.75% working interest) and CCBM (6.25% working interest)., as Quaneco opted out of maintaining a working interest in the eight wells. Other than the Castle Rock wells, RMG and CCBM both have a 50% working interest in all of these wells (see Table 2 below).

As of May 31, 2002, CCBM and RMG have spent approximately \$2,755,000 of the \$5,000,000 drilling fund. We are relying on the \$2,245,000 balance to pay for 100% of the drilling and completion costs on up to 36 more wells currently permitted, for which work is scheduled from April 2002 through September 2002: 19 wells on the Clearmont prospect (estimated costs \$1,700,000); 9 wells on the Bobcat prospect (estimated costs \$800,000); and 6 wells on the Arvada prospect (estimated costs \$550,000); and 2 wells on the Oyster Ridge prospect (estimated cost \$150,000) Like previous wells drilled with the CCBM drilling fund, RMG will have a 50% carried working interest (no financial obligation to RMG for a well's costs until after the drilling fund reaches \$5,000,000 spent by CCBM). Work would be delayed if CCBM were not able to fund these costs. Presently we do not have the capital resources to fund these costs, and would have to obtain the necessary capital from other industry partners or from sale of equity in the company.

Future annual financial obligations for our coalbed methane properties consist of approximately \$222,000 for the period through fiscal 2003 in acreage rental fees to lessors, and drilling permit renewal fees, which will be paid 50% by RMG and 50% by CCBM on all acreage except Castle Rock, and 21,536 acres within Oyster Ridge which are not covered by the option with Anadarko. Those costs and fees for Castle Rock will be paid 43.75% by RMG, 6.25% by CCBM, and 50% by Quaneco, except for the eight wells owned by RMG and CCBM, which will be paid 93.75% by RMG and 6.25% by CCBM.

Table 2 shows the wells drilled on RMG's prospects from May 31, 2000 through May 31, 2002. Under the agreement with Carrizo, RMG has a carried working interest in all these wells (with the exception of a \$156,634 payment that was made by RMG to cover 50% of a non-consent cost for 12 wells; CCBM also paid \$156,634 to cover 50% of their cost in acquiring a non-consent working interest in those 12 wells), as CCBM has paid for all drilling and completion costs on the wells other than the 19 Castle Rock wells. RMG has a carried working interest in the eight Castle Rock wells which were completed (out of the 19 drilled in that prospect), as SENGAI paid for all drilling and completion costs on the eight Castle Rock wells under a drilling program completed in December 2001. RMG owns a 93.75% working interest and CCBM owns a

6.25% working interest in the eight Castle Rock wells (CCBM paid for its interest in these wells, see "SENGAI - Option and Farmin Agreement"). With the exceptions noted above, all the wells on the Oyster Ridge, Clearmont and Arvada prospects have been drilled at CCBM's sole expense since its participation began on June 30, 2001. Table 2 lists the number of wells drilled, the total costs and the remaining number of wells currently permitted for drilling as of May 31, 2002.

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TABLE 2

ROCKY MOUNTAIN GAS, INC.

| PROSPECT | FY 2001 (6/1/00 - 5/31/01) | | FY 2002 (6/1/01 - 5/31/02) | | TOTAL | |
|--------------|-------------------------------|------------|-------------------------------|--------------|-------|--------------|
| | Wells | \$ | Wells | \$ | Wells | \$ |
| Castle Rock | 3 | \$ 283,894 | 19* | \$ 2,500,000 | 22 | \$ 2,783,894 |
| Kirby | 0 | \$ - | 0 | \$ - | 0 | \$ - |
| Oyster Ridge | 2 | \$ 150,503 | 5 | \$ 464,170** | 7 | \$ 614,673 |
| Clearmont | 0 | \$ - | 28 | \$ 1,470,351 | 28 | \$ 1,470,351 |
| Arvada | 0 | \$ - | 1 | \$ 64,790 | 1 | \$ 64,790 |
| TOTAL | 5 | \$ 434,397 | 53 | \$ 4,499,318 | 58 | \$ 4,933,713 |

* Drilled by SENGAI

** These costs include an additional \$169,314 spent on the two wells drilled during fiscal 2001.

BOBCAT PROPERTY. On April 12, 2002, the company and Rocky Mountain Gas, Inc. signed an agreement to purchase working interests in approximately 1,940 gross acres of coalbed methane properties in the Powder River Basin of Wyoming. The properties are located approximately 25 miles north of Gillette, Wyoming, in Campbell County. To date, 18 coalbed methane wells have been drilled; 13 wells are currently hooked up and produced in June 2002 at a combined rate of approximately 878,000 cubic feet of gas per day (878 Mcf) from the two primary coals on the property: the Cook coal (11 wells) at 650 feet, and the Canyon coal (2 wells) at 450 feet. Production began in late December 2001 (before RMG acquired the property).

There are no proved reserves established for this property.

For June 2002, RMG received an average price of \$1.10 per Mcf (1,000 cubic feet) for the 26,342 Mcf of gas sold from the Bobcat field. See "Gathering and Transmission of CBM Gas" below. The property was producing at uneconomic rates of production at this price. RMG is replacing and upgrading some equipment and adding a compressor, with the expectation of improving production volumes through the remainder of 2002 and thereafter. An independent evaluation of CBM reserves will be undertaken and completed by February 14, 2003, regardless of whether production increases from the June 2002 levels, and regardless of gas prices when the reserve evaluation is made. Reserve information will be disclosed when available. No independent reserve evaluation has been started to date, as RMG needed to take over operations of the field and obtain data after the property was purchased in June 2002.

Permits have been issued to the seller for drilling 36 more wells on 80 acre spacing.

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CCBM has exercised its right to participate in purchase of the Bobcat property, for 50% of the interests in the property subject to the agreement. For information on agreements with CCBM, please see "Carrizo - Purchase and Sale Agreement" below. RMG operates the property.

The seller keeps as an overriding royalty interest all net revenue interest in the properties in excess of 80%.

The contract closed on June 4, 2002. The company paid the seller \$500,000 cash and another \$150,000 by issuing 37,500 shares of restricted common stock to the seller; CCBM paid \$500,000 cash to the seller and Carrizo Oil & Gas, Inc. issued restricted shares of its common stock valued at \$150,000.

CARRIZO - PURCHASE AND SALE AGREEMENT. On July 10, 2001, RMG closed a Purchase and Sale Agreement with CCBM, Inc., a Delaware corporation which is wholly-owned by Carrizo Oil & Gas, Inc., Houston, Texas (NMS "CRZO"). The agreement between CCBM and RMG is intended to finance the further development of the acreage prospective for coalbed methane currently owned by RMG in Montana and Wyoming, and to acquire and develop more acreage in Wyoming and the Powder River Basin of Montana.

RMG has assigned CCBM an undivided 50% interest in all of RMG's existing coalbed methane properties (with the exception of Castle Rock of which only a 6.25% working interest was assigned) for a purchase price of \$7,500,000 by a promissory note payable in principal amounts of \$125,000 per month plus interest at an annual rate of 8%, over 41 months (starting July 31, 2001) with a balloon payment due on the forty-second month. These properties consisted of the Kirby, Oyster Ridge, Clearmont, Sussex, Finley, Baggs North, and Gillette North properties. The 50% undivided interest is pledged back to RMG to secure the purchase price, and will be released 25% when 33.3% of the principal amount (\$2,500,000) of the purchase price is paid, another 25% when total principal payments reach 66.6% of the principal amount (\$5,000,000) of the purchase price, and the balance of the total 50% undivided interest when all of the principal amount (\$7,500,000) of the purchase price, has been paid.

CCBM has the right to participate in other properties RMG may acquire (like the Bobcat property) under the area of mutual interest ("AMI"), see Agreement for Purchase of the Bobcat Property" above, and information on the AMI below.

To start development, and as part of the consideration for the acquisition, CCBM agreed to pay \$5,000,000 to drill and complete from 30 to 60 wells on the coalbed properties. RMG will be "carried" for its 50% interest in these wells, and will not be required to pay any of such costs. After the initial \$5,000,000 has been spent, RMG and CCBM each will pay for their 50% share of costs in subsequent wells, and also will pay for their 50% share of operating costs for the wells drilled and completed in this drilling program. Without CCBM's consent, none of the drilling funds can be used for operations associated with water disposal wells, gas compression beyond 100 PSIG, or for facilities downstream of compression beyond 100 PSIG. CCBM will earn a 50% working interest in each well location (80 acres) and gas production therefrom, regardless of the status of payments on the promissory note.

Drilling under the CCBM agreement started in August 2001. As of March 31, 2002, CCBM has spent approximately \$1,800,000 of the \$5,000,000 work commitment on the drilling of 22 wells at Clearmont, 4 wells at Oyster Ridge, 1 well at Arvada, and has funded \$225,000 of the drilling conducted by SENGAI in Montana as part of the Quaneco agreement. Amounts remaining out of the \$5,000,000 will be used for drilling during the remainder of fiscal 2002 and on into fiscal year 2003, or applied to property acquisitions, as agreed upon by the parties. If

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less than the entire \$5,000,000 is spent within two years (subject to extensions due to force majeure), CCBM shall pay RMG one-half the unspent portion of the \$5,000,000. However, this payment obligation back to RMG is subject to RMG complying with all of the terms and provisions of the Purchase and Sale Agreement, the joint operating agreement, and the procedures therein set

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forth regarding authorizations for expenditures to drill \$5,000,000 worth of "reasonable wells". This means wells which meet these economic criteria: (1) individual well cost (including hook-up to sales) must meet a projected internal rate of return in excess of 15% at prevailing market prices; (2) the wells must be on acreage blocks that are touching and contain minimum sizes (Kirby prospect, at least 2,560 acres; Clearmont, at least 640 acres; and Arvada, at least 480 acres); and (3) no more than 10 wells per calendar year at Oyster Ridge will qualify as reasonable. The intent of this provision is for CCBM to spend \$2,500,000 on behalf of RMG. If CCBM fails to do this despite a total of \$5,000,000 of reasonable well proposals by RMG, then CCBM shall be obligated to pay any remaining unspent portion of the \$2,500,000 directly to RMG.

In addition to its one-half share of revenues in proportion to its one-half share of the working interest, CCBM will be entitled to a credit (applied as a prepayment of the purchase price for the undivided 50% interest in RMG's acreage), equal to 20% of RMG's net revenue interest from wells drilled with the \$5,000,000 drilling budget, until the amount of that credit in favor of CCBM equals \$1,250,000.

RMG is the designated operator under a Joint Operating Agreement between RMG and CCBM., which will govern all operations on the properties subject to the Purchase and Sale Agreement between RMG and CCBM subject to pre-existing JOA's with other entities, and operations or properties in the area of mutual interest ("AMI"). The AMI is established for a four-year term starting June 30, 2001 and ending June 30, 2005. It covers the entire state of Wyoming, and the Powder River Basin of Montana, but will be reduced if CCBM does not obtain at least \$20 million for future property acquisitions (see below).

A management committee will oversee all operations subject to the Purchase and Sale Agreement, with two members each from CCBM and RMG, however, RMG shall have a tie-breaking vote until the \$5,000,000 drilling commitment has been expended and until the purchase price has been paid. Once the \$5,000,000 drilling commitment has been expended and the full purchase price is paid, RMG will allocate (with Quaneco's consent) to CCBM one of RMG's managing member positions with Powder River Gas LLC, which is the operative entity for the Montana acreage RMG holds with Quaneco L.L.C.

With respect to the Castle Rock prospect in Montana, which was subject to the agreement with SENGAI, RMG was entitled to have CCBM pay for \$225,000 of RMG's drilling obligations; for this funding (part of the \$5,000,000 drilling program with CCBM), CCBM received an undivided 6.25% working interest on each well so drilled and the 80 acre spacing allocated to each such well, i.e. one-half of our 12.5% working interest, during the SENGAI drilling program. CCBM made the \$225,000 payment to RMG on March 26, 2002, and RMG has subsequently paid SENGAI that amount to fulfill its outstanding obligation to SENGAI and Quaneco. See "Quaneco - Agreement" and "SENGAI - Option and Farmin Agreement."

Under the Purchase and Sale Agreement with CCBM, CCBM will use its best efforts to obtain financing to raise no less than \$20,000,000 to be used by RMG to acquire more properties in the AMI. CCBM would have a 50% working interest in

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properties so acquired. If CCBM's efforts are not successful by June 30, 2002, the AMI shall be reduced to a 6-mile radius from all existing properties held jointly by RMG and CCBM unless RMG agrees to an extension of this time frame by no later than December 20, 2002.

QUANECO - AGREEMENT. On January 3, 2000, RMG purchased a 50% working interest and 40% net revenue interest in the Castle Rock and Kirby prospects in the Powder River Basin of southeast Montana consisting of approximately 185,000 net mineral acres from Quaneco, L.L.C. (formerly Quantum Energy, L.L.C., Cleveland, Ohio and Oklahoma City, Oklahoma). The acreage includes 88,410 net acres of Bureau of Land Management ("BLM") land, 14,916 net acres of state land (Montana), and 82,775 net acres of fee land. In fiscal 2000 and 2001, RMG paid Quaneco the cash purchase price of \$5,500,000 for the acreage.

A separate provision in the Quaneco agreement required RMG to spend \$2,500,000 to drill and complete 25 wells. Under the subsequent Option and Farmin Agreement with SENGAI, SENGAI paid

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\$2,000,000 in their first drilling program on this prospect, and RMG paid \$250,000. Of this amount, \$225,000 was paid to RMG by CCBM and subsequently paid over to SENGAI, leaving RMG with a net obligation of \$25,000, which was paid. RMG has previously performed work and paid costs for a credit of approximately \$250,000 on the Castle Rock and Kirby prospects. All of RMG's drilling obligations to Quaneco therefore have been fulfilled.

The Kirby prospect, owned originally by RMG and Quaneco, and now CCBM as well, is operated through Powder River Gas, LLC, a Wyoming limited liability company. Initial CBM well sites have been selected by the management committee in which Quaneco and RMG currently have equal representation. USECC has the right to provide drilling services on the first 25 wells drilled by Powder River Gas, LLC based on competitive drilling rates in the area surrounding the wells to be drilled. Thereafter, USECC will have the right to submit bids on a competitive basis to Powder River Gas LLC for drilling contracts on additional acreage. CCBM has recently acquired 50% of RMG's interest in the Kirby prospects leaving ownership interest at 25% RMG, 25% CCBM, and 50% Quaneco.

SENGAI - OPTION AND FARMIN AGREEMENT. On February 8, 2001, RMG closed an Option and Farmin Agreement with Suncor Energy Natural Gas America, Inc. ("SENGAI"). SENGAI had an option to exercise on two blocks of acreage covering 111,566 net acres in southeast Montana; the option on the second block of acreage was contingent upon SENGAI exercising its option on the first block of acreage. The option on the first block of acreage expired on February 8, 2002, and SENGAI did not exercise its option to purchase the first block of acreage. Following is a summary of the option terms as related to the Option and Farmin Agreement with SENGAI, the benefits of which will now not be realized by RMG or Quaneco, and the benefits realized to date from the original terms of the Agreement (i.e. drilling and well ownership)

Under the terms of the Option and Farmin Agreement, had SENGAI exercised its option on the first block of acreage, SENGAI would have received 75% of RMG's 50% working interest and 25% of Quaneco LLC's 50% working interest in a total of 111,566 net acres in southeast Montana. As this acreage was under option with SENGAI at the time the CCBM agreement was entered into, RMG sold CCBM 50% of the 12.5% working interest (or 6.25%) it held (see Carrizo - Purchase and Sale Agreement). The Option and Farmin Agreement was divided into two blocks of acreage, the first and largest of which included 105,265 net acres

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and expired February 8, 2002. If SENGAI had exercised this option, the net payment to both RMG and Quaneco would have been \$3,684,299 total, and RMG's 75% share would have been \$2,763,224. The second block of acreage included 6,301 net acres and would have expired February 8, 2003. The amounts payable to RMG and Quaneco (had this option been exercised) would have been \$239,452 total, and RMG's share would have been \$179, 589.

Under the Option and Farmin Agreement, SENGAI committed to pay for all costs up to \$2,000,000 in a \$2,250,000 drilling program on the first block of acreage, starting in the fall of 2001. RMG had to pay the remaining \$250,000 for the drilling program (on its behalf and for Quaneco LLC, which completes RMG's drilling commitment to Quaneco; see below). SENGAI had to complete the drilling program regardless of whether it exercised the options. SENGAI completed this program in the fall of 2001.

As the first option was not exercised, all of the work paid for under the drilling program will benefit RMG (and now CCBM and Quaneco in their respective working interests), and SENGAI has no rights in the Castle Rock prospect or in any wells drilled on it.

RMG believes that SENGAI declined to exercise the option based on SENGAI's evaluation of incomplete data generated by SENGAI's drilling program, which SENGAI designed and executed. When SENGAI drilled the 19 exploratory wells under its option on the Castle Rock prospect, SENGAI did not utilize the best available procedures to detect possible CBM content. In addition, 6 of the wells were drilled in a pod configuration but 5 of the 6 were drilled into separate coal seams, even though efficient dewatering

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requires multiple close-spaced wells into the same coal. Eleven of the other SENGAI-drilled wells confirmed the presence of coal at the depths originally estimated by RMG, but otherwise insufficient data was generated by the drilling and testing of these 11 wells to determine if the coal might be productive of CBM.

RMG, Quaneco and SENGAI have signed a Project Completion Agreement, whereby Powder River Gas L.L.C. (an operating company owned equally by RMG and Quaneco) will become the operator of record for the Castle Rock properties and SENGAI's working interest will revert to 0% in the project. In addition, RMG has elected to accept a 93.75% working interest in (and RMG will operate) 8 completed wells in the Castle Rock area. CCBM has a 6.25% working interest in these 8 wells.

RMG believes that although the data on the 8 wells to be retained by RMG is incomplete (which wells were drilled by SENGAI), RMG will further evaluate the data. If the results are favorable, RMG will start dewatering these wells and establish a pod grid to drill and complete and start dewatering more wells around each existing well to maximize dewatering efficiency. As with any CBM project, a substantial amount of dewatering of pods of wells into the same coal is necessary before the economics of the wells can be assessed. We have not prepared a budget or timetable for this future work but expect to do so by March 31, 2003. This future work would start in spring 2003, subject to having the necessary funds on hand.

DESCRIPTION OF PROSPECTS

Leases of federal mineral rights are obtained from the United States Bureau of Land Management and expire from 2004 to 2009, unless RMG establishes

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production on the lease, in which event the lease is held so long as coalbed methane or other gas or oil is produced. A royalty interest of 12.5% on the production is paid to the BLM. State leases expire from 2003 to 2004 in Wyoming and Montana, unless RMG establishes production on the lease, in which event the lease is held so long as coalbed methane or other gas or oil is produced. The royalty paid to the State of Wyoming is 12.5 % to 16.666666% , and 12.5% to the State of Montana. Annual renewal fees for non-producing Federal leases is \$1.50 to \$2.00 per acre, and \$1.00 and \$1.50 for non-producing Wyoming and Montana leases.

Leases on private (fee) land for coalbed methane and conventional gas expire at various times from 2003 to 2011, unless production is established, in which event the lease is held so long as there is production. The landowner is paid a royalty from production of 12.5% to 20.0% , depending on the lease terms.

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Table 3

ROCKY MOUNTAIN GAS, INC.

| Prospect | Gross Leased Acres | Net Leased Acres | Net Leased from BLM | Net Leased from State of Wyoming | Net Lease from Stat Montana |
|----------------|-----------------------|---------------------|------------------------|--|-----------------------------------|
| Castle Rock | 123,840 | 111,567 | 55,104 | 0 | 10,860 |
| Kirby | 80,254 | 74,512 | 33,305 | 0 | 4,056 |
| Oyster Ridge* | 21,536 | 21,536 | 17,107 | 1,229 | 0 |
| Clearmont | 6,305 | 3,745 | 0 | 640 | 0 |
| Sussex | 640 | 640 | 0 | 640 | 0 |
| Finley | 160 | 160 | 0 | 160 | 0 |
| Baggs North | 120 | 120 | 0 | 120 | 0 |
| Gillette North | 80 | 80 | 0 | 80 | 0 |
| Arvada | 1,900 | 1,700 | 1,200 | 0 | 0 |

*Does not include acres under option from Anadarko Petroleum. See "Description of Properties - Oyster Ridge."

Table 3 does not include acreage in the Bobcat property.

CASTLE ROCK: The Castle Rock project consists of 123,840 gross and 111,567 net acres located in the northeastern portion of the Powder River Basin of Montana, west of Broadus, Montana. Coals present are in the Tongue River member of the Fort Union formation and appear comparable to coals currently being developed by other operators south of the Castle Rock acreage near the Montana/Wyoming border. Currently, there are no pipelines in this area. The federal leases generally have 10-year terms and fee and state leases generally have two to five year terms.

KIRBY: The Kirby project consists of 80,254 gross and 74,512 net acres located in the northwestern portion of the Powder River Basin in Montana located

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in Big Horn and Rosebud Counties, Montana, north of Sheridan, Wyoming. Coals are in the lower portion of the tertiary Fort Union formation and are similar to productive coals in the Wyoming portion of the Powder River Basin to the south. Redstone (recently acquired by Montana Dakota Utilities) has established significant coalbed methane production 12 miles south of Kirby at the CX field. At least two other operators are currently planning to drill and develop nearby acreage. CMS's Bighorn Gas Gathering recently extended a new 20" pipeline to within 10 miles of the Kirby project. Three exploration wells are currently scheduled to be drilled at Kirby during the summer of 2002.

OYSTER RIDGE: The Oyster Ridge project consists of 65,247 gross and net acres located in southwestern Wyoming in the Ham's Fork Coal Field adjacent to the Green River Basin. RMG and CCBM have a 100% working interest (50% each) in 21,536 acres within Oyster Ridge.

Anadarko Petroleum, Inc. is successor to Union Pacific Land Resources Corporation, which sold the acreage subject to UPLRC's back in option to third parties, from whom RMG acquired the acreage in December 1999.

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The agreement with Anadarko is a drill-to-earn-acreage agreement: we must drill at least four wells each year, each on a new section (640 acres), to earn a lease on each drilled section, and also to keep in force previously earned leases in the 43,711 acres areas. Wells drilled by our seller, and by us (with CCBM), have earned 3,200 acres, which are included in the 21,536 acres leased presently. As of March 31, 2002, we have met our drilling obligations for the year ended March 31, 2002. Under the terms of the agreement, we must drill 4 additional wells by March 31, 2003 to keep our agreement in force. RMG expects to meet this drilling commitment.

Within this prospect, 43,711 gross acres are subject to an option held by Anadarko Petroleum, Inc. to participate as a 25% working interest owner on all wells drilled each year. Anadarko has not yet elected to participate, and has no working interest in the seven wells drilled to date on this prospect. If Anadarko elects to participate in the future, working interest ownership in affected wells would be of 37.5% RMG, 37.5% CCBM, and 25% Anadarko.

The area is prospective for coalbed methane production from two primary Cretaceous age coals, the Frontier and the Adaville. The Kern River pipeline, which services southern California, crosses the property. Exploratory drilling and completion operations on previously drilled wells resumed at Oyster Ridge in June, 2001. To date, \$621,128 has been spent on 7 exploratory wells.

CLEARMONT: The Clearmont project consists of approximately 5,345 gross and 2,785 net acres located in the western Powder River Basin of Wyoming. RMG (and now CCBM jointly) owns working interests ranging from 25% to 100%. The area is characterized by several shallow Fort Union coalbeds (most notable the Roland and Anderson coals) as well as several deeper coals that hold significant exploration potential. Substantial coalbed methane production and development is ongoing in the immediate area including Federated's Box Elder Creek project 12 miles to the west and the Penneco/CMS Wild Horse Creek project 15 miles to the east. The Clearmont project is located at the convergence of the WBI Bitter Creek and the Bighorn Sheridan Lateral pipelines. A 28 well exploration and development drilling program began at Clearmont in August 2001 and could be in production in 2002 depending on drilling results and gas prices. As of May 31, 2001, \$1,470,351 has been spent on drilling and infrastructure at Clearmont.

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SUSSEX: RMG and CCBM hold 640 gross and net acres in this project area located in Johnson County, Wyoming. This State lease lies 3 miles south of Sussex, Wyoming. RMG has a 100% working interest. To date, RMG has not conducted any significant development on the property.

FINLEY: RMG and CCBM hold 160 gross and net acres in this project area located in Converse County, Wyoming. This prospect is a State lease 12 miles east of Edgerton, Wyoming. Review for a two well test is underway. To date, RMG has not conducted any significant development on the property.

BAGGS NORTH: This prospect contains 120 gross and net acres located in Carbon County, Wyoming. This State lease is located 7 miles north of Baggs, Wyoming. RMG and CCBM hold a 100% working interest in this prospect. To date, RMG has not conducted any significant development on the property.

GILLETTE NORTH: RMG and CCBM holds a 100% working interest in 80 gross and net acres in this project area located in Campbell County, Wyoming. This State lease lies at the north end of the City of Gillette. Existing coalbed methane wells lay in the section immediately north. Permitting of two wells has begun on RMG's property. RMG intends to conduct test drilling and production techniques in this area which lies in the heart of the current coalbed methane play in the Gillette area. To date, RMG has not conducted any significant development on the property.

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ARVADA: This prospect contains 1,900 acres located in Sheridan County, Wyoming. RMG and CCBM hold a 100% working interest, and a 62% to 81.5% net revenue interest. To date, RMG and CCBM have spent \$64,428 on the drilling of one 1,471' deep test well and analysis drilling results.

COALBED METHANE WELL PERMITTING. Drilling coalbed methane wells requires obtaining permits from various governmental agencies. The ease of obtaining the necessary permits depends on the type of mineral ownership and the state in which the property is located. Intermittent delays in the permitting process can reasonably be expected throughout the development of any play. For example, there is currently a temporary moratorium for drilling coalbed methane wells on fee and state lands in Montana. We may shift our exploration and development strategy as needed to accommodate the permitting process. As with all governmental permit processes, there is no assurance that permits will be issued in a timely fashion or in a form consistent with our plan of operations.

On March 16, 2000, the Northern Plains Resource Council, Inc. ("NPRC") filed suit against the Montana Board of Oil and Gas Conservation (Board) requesting an order of the court compelling the defendant to prepare a Draft Environmental Impact Statement ("EIS") and amendment of the Powder River and Billings Resource Management Plans for coalbed methane development, which could further delay development. RMG and others have filed a motion to intervene to participate in this litigation and to ensure that some drilling can be performed during any environmental analysis. The Board has agreed to limit issuance of CBM well permits to 200 (of which RMG received 79 of these permits) pending completion of the EIS, which is currently scheduled to be completed in the summer of 2002.

The Wyoming Department of Environmental Quality Supplemental Environmental

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Impact Statement (SEIS) for the Powder River Basin in Wyoming, issued in the fall of 1999, allowed the permitting of 5,000 CBM wells to be drilled on Federal lands in Wyoming. More CBM well applications have been submitted causing the BLM to begin a second EIS for the Powder River Basin Area in Wyoming. The new draft EIS is scheduled to be completed in the fall of 2002. Development on Federal lands in Wyoming has been stopped with the balance of the Wyoming Department of Environmental Quality EIS permitted wells (4,000) occurring on fee and state lands. The BLM completed an environmental assessment ("EA") in March 2001, reviewing drainage issues, which could allow an additional 1,500 new CBM well permits in the Gillette region of the Powder River Basin. The EA and EIS may impact RMG's operations, as the Arvada prospect is within the affected area, and we expect to begin applying for permits in these prospects in late 2002.

In addition, the Wyoming and Montana Departments of Environmental Quality have regulations applying to the surface disposal of water produced from CBM drilling operations. CBM operators are currently seeking changes in permit requirements and department policy that would allow operators more flexibility to discharge water on the surface. If these changes are not made, it may be necessary to install and operate treatment facilities or drill disposal wells to reinject the produced water back into the underground rock formations adjacent to the coal seams or lower sandstone horizons. If we cannot obtain the appropriate permits or if applicable laws or regulations require water to be disposed of in an alternative manner, the costs to dispose produced water will likely increase. These costs could have a material effect on operations in this area, including potentially rendering future production and development in the affected areas uneconomic.

RMG has received an Environmental Assessment and Finding of No Significant Impact to drill up to 56 shallow gas sand wells. These wells are located on Federal land held with Quaneco and would be converted to production status upon receiving approval from the Montana Board of Oil and Gas. These wells would evaluate potential CBM production as well as conventional gas. Regarding other acreage held with Quaneco in Montana, the State of Montana may lift its moratorium for CBM wells on private and state ground in Montana, and start issuing new permits on these lands in Summer 2002 (a voluntary moratorium is currently in place for wells on private and state ground in Montana). We have not determined to what extent we will

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participate in this procedure, and are evaluating how best to protect our position to have reasonable exploration for CBM wells proceed on state and fee ground. We have permits in place until Spring 2002 in order to conduct exploration in expectation that commercial production will be approved on completion of the EIS.

In August 2001, Montana and Wyoming announced an agreement for water quality officials in both states to coordinate monitoring of water flows in the Powder River and Little Powder River drainages, to determine the impact of coalbed methane well water production on river water. Although usually well water is drinkable, it may contain high sodium absorption ratios, which can impair use of the water for irrigation purposes in clay-based soils. The respective agencies will propose regulations to establish thresholds for potential pollutants and require strict monitoring by local water quality officials. If test results indicate some well water flows adversely impact river water quality, operators could be required to put the water flow into holding ponds or take other steps to eliminate or reduce water flows or pollutants in the water. Implementation of the agreement may benefit continued coalbed methane

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development in these areas by opening up the water discharge permitting process in the affected areas, as water testing is completed in phases on prospects within the affected drainage areas. Currently, we don't have acreage that would be impacted by these regulations but future acreage could be acquired in the affected areas.

The following summarizes permits now in place.

Table 4

| Prospect | Remaining Permits | Expiration or Renewal Date |
|-------------|-------------------|--|
| Castle Rock | 15 | 04/17/2003 and 10/17/2002 |
| Kirby* | 6 | 04/23/2002; 05/05/2002 and 05/16/2002 |
| Clearmont | 46 | 07/31/2002; 08/30/2002; 09/26/2002; 10/24/2002; 11/01/002; 11/02/2002; 02/04/2003 and 03/15/2003 |
| Arvada | 3 | 11/12/2002 and 04/22/2002 |
| Total | 70 | |

*RMG has requested extensions for these permits.

Drilling permits issued by the State of Wyoming allow one year for drilling completion; while permits issued by the State of Montana allow six months.

Once drilled, all wells in the Clearmont and Arvada prospects remain (and future wells in Wyoming will be) subject to a National Pollution Discharge Elimination System ("NPDES") permit relating to water testing and discharge. All wells in the Castle Rock and Kirby prospects remain subject to the Montana Board of Oil and Gas Commission approval. Upon completion of drilling all of the wells are subject to monthly reporting regarding status and production to the respective state agencies in which they are located.

GATHERING AND TRANSMISSION OF CBM GAS

Companies involved in CBM production generally outsource their gas gathering, compression and transmission. We intend to outsource compression and gathering needs as well, possibly on a competitive basis with transmission companies in the immediate area. Negotiations with various transmission companies have been initiated in order to better manage future capital investment, but no contracts have been signed to date.

Coalbed methane production growth in the Powder River Basin has historically been impeded by a shortage of gathering system capacity and transport capacity out of the Basin. However, two large diameter gathering pipelines were completed in September 1999 and a third was ready for service in early 2000. The two completed pipelines will provide an additional 900 million

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cubic feet, (MMcf), of daily gas capacity as set forth below:

Fort Union Gas Gathering, LLC's 106-mile, 24" gathering pipeline, commenced operations September 1, 1999, with an initial capacity of 450 MMcf per day; and

Thunder Creek Gas Services, LLC's 126-mile, 24" gathering pipeline, commenced operations September 1, 1999, with an initial capacity of 450 MMcf per day.

Additionally, CMS Energy's 110-mile, Big Horn Gas Gathering pipeline, that connects to the northern terminus of the Fort Union pipeline, is continuing to be expanded in length and has an initial capacity of 256 MMcf per day which can readily be upgraded to 500 MMcf per day with the addition of booster compression. Further, on June 19, 2000, Big Horn Gas Gathering announced the extension of its pipeline to serve producers in the Sheridan area. This 50+ mile extension will place a 20" high pressure pipeline within 5 miles of the Montana border and within close proximity to the development planned by RMG, CCBM, and Quantum on their Kirby Prospect area.

Wyoming Interstate Gas Company's 143-mile, 24" Medicine Bow Lateral pipeline commenced operations in November 1999 with an initial capacity of 260 MMcf per day. This pipeline will transport natural gas from the Thunder Creek and Fort Union pipelines at the south end of the Powder River Basin to interconnect with multiple interstate pipelines accessing markets to the east and along the front range of Colorado. This system is already being expanded as demand for transportation space grows. Further transmission lines are being planned by other companies in the area.

Wyoming operators have been realizing lower than expected prices for gas produced in the Powder River Basin, due in part to seasonal/supply factors, but more significantly due to a bottleneck in take away capacity. There is now ample capacity to move gas from CBM fields within the PRB but limited interstate movement capacity from the PRB to the major markets on the coasts and in the midwest, which results in a negative price differential. The newly announced Grasslands Pipeline (to be constructed to move gas to midwest and northern markets) and the additional looping (now under construction) of the Kern River Pipeline, will add 1,000 MMcf daily PRB take away capacity when completed by the end of 2003, and should reduce the negative price differential.

For June, 2002, RMG received an average price of \$1.10 per Mcf (1,000 cubic feet) of gas produced from the Bobcat field. This represents a negative price differential of approximately 66% compared to the average price of approximately \$3.24 per Mcf received by producers nationwide. While increased pipeline capacity planned or under construction is expected to reduce this negative price differential by the end of 2003, there is no guarantee that the increase will eliminate the negative price differential or even significantly reduce it. Continued low prices would impair our ability to raise capital for RMG and reduce revenues from production coming on line.

GENERAL INFORMATION ABOUT COALBED METHANE.

Methane is the primary commercial component of natural gas produced from conventional gas wells. Methane also exists in its natural state in coal seams. Natural gas produced from conventional wells generally contains other hydrocarbons in varying amounts which require the natural gas to be processed. Methane gas produced from coalbeds generally contains only methane and is pipeline-quality gas after simple water dehydration.

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Coalbed methane production is similar to conventional natural gas production in terms of the physical producing facilities. However, the subsurface mechanisms that allow gas movement to the wellbore are very different. Conventional natural gas wells require a porous and permeable reservoir, hydrocarbon migration and a natural structural or stratigraphic trap. Coalbed methane gas is trapped (adsorbed) in the coal itself and in the water contained in the pore space, until released by pressure changes when the water in the coal is removed. In contrast to conventional gas wells, new coalbed methane wells initially produce water for several months. As the formation water pressure decreases, methane gas is released from the structure.

Methane production is a direct result of reducing the hydrostatic (water) pressure in the coal formation. Three principal stages are involved:

- o Drill wells (typically eight or more in a 'pod') down to the same coal formation, in contiguous 80 acre spacing per well; test the water in the formation and test coal samples taken from the formation. Water testing determines if the geochemical environment of the coal seam was conducive to the formation of CBM.
- o Install gathering lines to hook up and put wells on pump to 'dewater' the coal formation. Hydrostatic pressure must be reduced to about 50% of initial pressure before enough data is obtained (water flow rates, CBM gas flows) to determine how much CBM the wells may produce. This dewatering stage may take 6 to 18 months, and in some instances 24 months (where there is no dewatering of the coal seam occurring from wells drilled by others on adjacent properties).
- o Installing (or have a transmission company install) a compressor and transport line to carry produced gas to a gas transmission line for sale to end users. Gas production starts gradually then continues to grow in volume as hydrostatic pressure is reduced; optimal production won't occur until hydrostatic pressure is reduced approximately 90% from initial levels.

Inactive Mining Properties - Uranium

GENERAL. We have interests in several uranium-bearing properties in Wyoming and Utah and in a uranium processing mill in southeastern Utah (the "Shootaring Mill" in Garfield County). All the uranium-bearing properties are in areas which produced significant amounts of uranium in the 1970s and 1980s. At some future date, we could develop and operate these properties (directly or through a subsidiary company or a joint venture) to produce uranium concentrates ("U3O8") for sale to public utilities that operate nuclear powered electricity generating plants. However, until uranium oxide prices improve significantly, all of the uranium properties are shut down, and work is performed to keep the properties ready for later activity and permitting work is done as needed (monitoring and reporting) to keep existing permits in effect.

The uranium properties have been shut down. Over a period of at least nine months, substantial and expensive work would be required to put them into production, including cleaning rock and other debris from shafts and tunnels, pumping water out of the mines, extending the shafts and tunnels, and sampling to ascertain whether a commercially viable ore body exists on any of the properties.

However, a decision to put the uranium properties into production will have

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to take into account the fact that presently uranium oxide prices are lower than mining and milling costs. These low prices are primarily due to ample supplies of uranium being produced by other companies from lower cost (and higher grade) deposits outside the United States, and also to stockpiles of uranium oxide being sold off by those producers.

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This low price situation has created conditions that have adversely impacted our ability to go into production. We cannot predict when uranium oxide prices might increase sufficiently to warrant putting our uranium properties into production. Such increases may not occur for several years, if at all.

At May 31, 2001 and 2000 (the dates of the consolidated balance sheets in this report), there are no values carried on the balance sheets for uranium properties.

SHEEP MOUNTAIN - WYOMING

Unpatented lode mining claims, underground and open pit uranium mines and mining equipment in the Crooks Gap area are located on Sheep Mountain in Fremont County, Wyoming and are adjacent to and west of the GMMV mining claims. From December 21, 1988 to June 1, 1998, these properties were held by Sheep Mountain Partners ("SMP"). On June 1, 1998, USE received back from SMP all of the Sheep Mountain mineral properties and equipment, in partial settlement of disputes with Nukem, Inc. ("Nukem") and its subsidiary Cycle Resource Investment Corp. ("CRIC"). The Judgment against Nukem impressing the CIS uranium supply contracts in constructive trust with SMP remain in dispute. See "Legal Proceedings." The Sheep Mountain Mines 1 and 2 were first operated by Western Nuclear, Inc., a subsidiary of Phelps Dodge Corporation, in the late 1970s.

We have recorded reclamation liabilities for the SMP properties (see note K to the consolidated financial statements in this report). All historical costs in the SMP properties were offset against a monetary award which was received from Nukem during fiscal 1999.

THE PROPERTY INTERESTS OF USE IN UTAH THROUGH PLATEAU RESOURCES LIMITED ("PLATEAU") ARE:

Plateau Resources Limited is a wholly-owned subsidiary of USE. See "Plateau Shootaring Canyon Mill" below.

The Tony M property contains underground uranium deposits in San Juan County, Utah, and are located partially on Utah State leases.

Plateau is the lessee of the Tony M property and has posted a bond securing Plateau's obligations to reclaim these properties. The Tony M property was originally developed by Plateau at the time Plateau was owned by Consumers Power Company ("CPC"), a Michigan public utility. Significant areas of uranium mineralization have been accessed and delineated by the prior owner's underground workings. When the Tony M property was in production (while Plateau was owned by CPC), it produced ore containing from three to eight pounds of

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uranium concentrates per ton. Some of this ore was processed at the Shootaring Mill. In addition, low grade uranium mineralization was stockpiled at the Tony M property and at the Shootaring Mill.

Plateau also acquired the Velvet property and the nearby Woods Complex in the Lisbon Valley area in southeastern Utah. The Velvet Mine was developed and permitted by its prior owner and is located approximately 178 miles by road from the Shootaring Mill. The prior owner drove several miles of access tunnels (adits) and drifts (access tunnels) and mined material from the workings. However, we cannot ascertain the amount or grade of material previously mined, nor have we ascertained by our own drilling the location and grade of remaining mineralized material in the mine. The Woods Complex was formerly an operating uranium mine with a remaining undeveloped resource. Access to this resource would be by extending a drift approximately 2,500 feet from the former Woods Mine. The Woods Mine property is not permitted, but we do not expect difficulty in obtaining a new permit, should we seek one, because the surface facilities would occupy the site that has been disturbed from previous operations.

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THE GREEN MOUNTAIN MINING VENTURE ("GMMV") PROJECT

GMMV. In fiscal 1991, we entered into an agreement to sell 50 percent of our interests in the Green Mountain uranium claims, and certain other rights, to Kennecott Uranium Company ("KUC" or "Kennecott"), a subsidiary of Kennecott Energy and Coal Company of Gillette, WY. Kennecott Energy and Coal Company is a subsidiary of Rio Tinto plc, formerly RTZ plc of London. In consideration of the sale to Kennecott, we received \$15,000,000 cash and a commitment by Kennecott to fund the first \$50,000,000 of GMMV expenditures, under a joint venture agreement (the "GMMV Agreement") to mine and mill uranium ore and market uranium oxide. For detailed explanation, please see U.S. Energy Corp's. 1999 Form 10-K at pages 8-11, and footnote F to the financial statements.

The GMMV holds 521 unpatented lode mining claims (the "Green Mountain Claims") on Green Mountain in Fremont County, Wyoming, including 105 claims on which the Round Park (Jackpot) uranium deposit is located, and the Sweetwater Mill (approximately 23 miles south of Green Mountain).

In fiscal 2000, Kennecott filed a lawsuit to dissolve the GMMV and we counterclaimed for damages. This lawsuit was settled on September 11, 2000. Kennecott paid USECC \$3,250,000 to acquire all of our (and Crested's and USECC's) interest in the GMMV, its properties and the Sweetwater Uranium Mill (with certain exceptions), and all parties' claims in the lawsuit have been dismissed. Kennecott also assumed all reclamation and other liabilities associated with the GMMV, its properties, the Sweetwater Mill and all liabilities associated with the GMMV since its inception, including the historical liabilities associated with the Sweetwater Mill prior to its acquisition by the GMMV. We and Crested together have retained a 4% net profits royalty in any future uranium oxide produced from the GMMV mining claims through the Sweetwater Mill (currently shut down and not operational).

No reclamation liabilities are recorded on our balance sheet for the GMMV

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properties because they are solely Kennecott's responsibility (Kennecott assumed all those liabilities when we settled litigation with Kennecott in September 2000 (see "GMMV" below and note K to the consolidated financial statements)).

At such time as Kennecott has completed necessary reclamation work on the Green Mountain unpatented lode mining claims (including the Round Park uranium deposit proposed to be mined through the Jackpot Mine) Kennecott will quit claim all such mining claims to us and Crested, as well as certain equipment currently being used at the mine (including a compressor and standby generator). Kennecott plans to keep the Sweetwater Mill.

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PROPERTIES

The Green Mountain Claims include the Big Eagle Properties on Green Mountain, which contain substantial uranium mineralization, and are adjacent to other mining claims. The Big Eagle Properties contain two open-pit mines, as well as related roads, utilities, buildings, structures, equipment and a stockpile of 500,000 tons of uranium material with a grade of approximately .05% uranium concentrate ("U3O8"). Uranium concentrate means natural uranium concentrates in the form of triuranium octoxide (U3O8) containing 0.711 (nominal) weight percent uranium in the isotope U-235. The assets include two buildings (38,000 square feet and 8,000 square feet) formerly used by Pathfinder Mines Corporation ("PMC") in mining operations.

The Round Park (Jackpot) mining claims contain deposits of uranium which have been estimated to contain 11,410,000 tons grading 0.266% ("U3O8") mineralized material. These estimates are based on extensive drilling from the surface. Other than the two declines, no underground workings have been built, and we have not determined the location of any underground stopes containing mineralized material. The GMMV had planned to mine this mineralized material from two decline tunnels (-17 percent slope) in the Jackpot Mine driven underground from the south side of Green Mountain. The first of several mineralized horizons in the Round Park deposits, is about 2,300 feet vertically down from the surface of Green Mountain. This work was halted in July 1998.

SWEETWATER MILL. In fiscal 1993, the GMMV acquired the Sweetwater uranium processing mill and associated properties located in Sweetwater County, Wyoming, approximately 23 miles south of the proposed Jackpot Mine, from a subsidiary of Union Oil Company of California ("UNOCAL"), primarily in consideration of Kennecott and the GMMV assuming environmental liabilities, and decommissioning and reclamation obligations. The Sweetwater Mill was designed as a 3,000 ton per day ("tpd") facility.

As consideration for acquiring the Sweetwater Mill, GMMV agreed to indemnify UNOCAL against certain reclamation and environmental liabilities, which indemnification obligations are guaranteed by Kennecott Corporation (parent of Kennecott Uranium Company). The GMMV is responsible for compliance with mill decommissioning and land reclamation laws, for which the environmental and reclamation bonding requirements are approximately \$24,330,000, which includes a \$4,560,000 bond required by the Nuclear Regulatory Commission ("NRC"). None of the GMMV future reclamation and closure costs are reflected in the consolidated financial statements.

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The reclamation and environmental liabilities assumed by the GMMV (and now Kennecott's sole responsibility) consist of three categories: (1) cleanup of the inactive open pit mine site near the Mill (the source of ore feedstock for the mill when operating under UNOCAL), including water (heavy metals and other contaminants) and tailings (heavy metals dust and other contaminants requiring abatement and erosion control) associated with the pit; (2) decontamination and cleanup and disposal of the Mill building, equipment and tailings cells after Mill decommissioning; and (3) cleanup of the twin tunnels driven into Green Mountain by the GMMV. The Wyoming Department of Environmental Quality ("DEQ") exercises delegated jurisdiction from the United States Environmental Protection Agency ("EPA") to administer the Clean Water Act and the Clean Air Act, and directly administers Wyoming statutes on mined land reclamation. The Sweetwater Mill is also regulated by the NRC for tailings cells and mill decontamination and cleanup. The EPA has continuing jurisdiction under the Resource Conservation and Recovery Act, pertaining to any hazardous materials which may be on site when cleanup work is started.

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PLATEAU'S SHOOTARING CANYON MILL

ACQUISITION OF PLATEAU RESOURCES LIMITED ("PLATEAU"). In August 1993, USE purchased from Consumers Power Company ("CPC"), all of the outstanding stock of Plateau which owns the Shootaring Canyon uranium processing mill and support facilities in southeastern Utah (the "Shootaring Mill") for a nominal cash consideration. The Shootaring Mill holds a source materials license from the NRC. In the purchase of the stock from CPC, we agreed to various obligations, as disclosed in USE's 1998 Form 10-K at pages 15 and 16.

SHOOTARING MILL AND FACILITIES. The Shootaring Mill is located in southeastern Utah and occupies 19 acres of a 265 acre plant site. The mill was designed to process 750 tpd, but only operated on a trial basis for two months in mid-summer of 1982. In 1984, Plateau placed the mill on standby because CPC had canceled the construction of an additional nuclear energy plant.

Plateau also owns approximately 90,000 tons of uranium mineralized material stockpiled at the mill site and approximately 172,000 tons of mineralized material stockpiled at the Tony M property. Included with mill assets are tailings cells, laboratory facilities, equipment shop and inventory. The NRC issued a license to Plateau authorizing production of uranium concentrates, however, since the mill was shut down, only maintenance and required safety and environmental inspection activities were performed and the source materials license with the NRC was for standby operations only. Plateau applied to the NRC to convert the source materials license from standby to operational and upon increasing the reclamation bond, the NRC issued the new license on May 2, 1997. Plateau has a cash bond in favor of the NRC in the amount of \$8,511,200 plus an additional \$1,136,800 in government securities for bonding future reclamation.

Plateau obtained approval of a water control permit for the tailings cell from the Utah Water Control Division and is awaiting the NRC's review of the operating license conditions so Plateau can continue with construction of tailing facilities if it so desires.

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The Shootaring Mill has remained shut down because of continued low uranium prices. Substantial expense would be incurred to upgrade the mill to operating status and fully activate the NRC permit, and substantial work would be needed to put the Velvet and Woods Complex properties into production for material to run through this mill. This work would include cleaning out adits and drifts, dewatering, and sampling to ascertain the location and grade of mineralized material.

TICABOO TOWNSITE

Plateau owns Canyon Homesteads, Inc., a Utah corporation, which developed the Ticaboo, Utah townsite 3.5 miles south of the Shootaring Mill. The townsite includes a motel, restaurant, lounge, convenience store and single family, mobile home and recreational vehicle sites (all with utility access), located on a State of Utah lease near Lake Powell. An amendment was entered into on April 1, 1997 on the Utah State lease covering the Ticaboo Townsite whereby the State will convey portions of the Townsite lease to Canyon on a sliding scale basis as they are sold. USE and Crested are developing the Townsite in limited fashion and are selling home and mobile home sites.

SHEEP MOUNTAIN PARTNERS ("SMP")

SMP PARTNERSHIP. In February 1988, USE acquired uranium mines, mining equipment and mineralized properties (Sheep Mountain Mines) at Crooks Gap in south-central Fremont County, Wyoming, from Western Nuclear, Inc. These Crooks Gap mining properties are adjacent to the Green Mountain uranium properties. USECC mined and milled uranium ore from one of the underground Sheep Mines during fiscal

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1988 and 1989. Production ceased in fiscal 1989, because uranium could be purchased from the spot market at prices below the mining and milling costs of USECC. In December 1988, USECC sold 50 percent of the interests in the Crooks Gap properties to Nukem's subsidiary Cycle Resource Investment Corporation ("CRIC") for cash. The parties thereafter contributed the properties to and formed Sheep Mountain Partners ("SMP"), in which USECC received an undivided 50 percent interest. SMP is a Colorado general partnership formed on December 21, 1988, between USECC and Nukem, Inc. then of Stamford, CT ("Nukem") through its wholly-owned subsidiary CRIC.

SMP was directed by a management committee, with three members appointed by USECC and three members appointed by Nukem/CRIC. The committee has not met since 1991 as a result of the SMP arbitration/litigation. During fiscal 1991, disputes arose between the SMP partners which resulted in litigation. See Item 3, Legal Proceedings.

PROPERTIES. Until June 1, 1998, SMP owned 80 unpatented lode mining claims on the Crooks Gap properties, including two open-pit and five underground uranium mines and an estimate of mineralized material. In connection with a partial settlement of litigation/arbitration between USECC and Nukem/CRIC, SMP conveyed these mineral properties and equipment to USECC. Any future production from the properties will continue to be subject to sliding-scale royalty payable

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to Western Nuclear, Inc. (1% to 4% on recovered uranium concentrates). As of the filing date of this Annual Report, USE , Crested and/or USECC own 98 unpatented lode mining claims and a 644 acre Wyoming State Mineral Lease in the Crooks Gap area.

An ion exchange plant is located on the SMP properties which was be used to remove natural soluble uranium from mine water. USE began reclamation of this facility during the first quarter of fiscal 2002. The plant is being disposed of at the Sweetwater Mill impoundment facility (see above). These reclamation costs were not covered by the settlement with Kennecott, because that settlement only covered GMMV properties. We are paying for the ion exchange reclamation costs, and Kennecott is allowing the contaminated materials to be buried at the Sweetwater impoundment facility.

PERMITS. Permits to operate existing mines (now shut down) on the Crooks Gap properties have been issued by the State of Wyoming. Amendments are needed to open new mines within the permit area. As a condition to issuance of the permits, a NPDES water discharge permit under the Clean Water Act has been obtained. Monitoring and treatment of water removed from the mines and discharged in nearby Crooks Creek is generally required. During the past two years, USECC did not discharge wastewater into Crooks Creek, and the mine water is presently being discharged into the USECC McIntosh Pit.

URANIUM MARKET INFORMATION.

URANIUM SPOT MARKET. Uranium restricted spot prices were \$8.75/lb. U308 on June 30, 2001, an increase of 8% from \$8.10 at June 30, 2000. During the first half of 2001, total spot market volume was approximately 7 million pounds U308 which was about the same volume as the first half of 2000.

URANIUM LONG-TERM MARKET. The long-term market has been active in 2001 with the long-term contracts reported by market analysts to have exceeded 35 million pounds of U308 during the first half of 2001. The uranium price indicator published by Tradetech was at \$10.00 per pound U308 at June 30, 2001, up from the \$9.75 at beginning of the second quarter of 2001.

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GOLD

SUTTER PROPERTY (California)

SUTTER GOLD MINING COMPANY. In fiscal 1991, USE acquired an interest in Sutter properties located in the Mother Lode Mining District of Amador County, California. The entire Lincoln Project (which is the name we use for the properties) is owned by Sutter Gold Mining Company, a Wyoming corporation ("SGMC"), and a majority-owned subsidiary of USE.

This property has never been in production. Persistent low prices for gold have made financing difficult, and in fiscal 1999 resulted in a substantial write down of the SGMC assets. See "Managements Discussion and Analysis of Financial Condition and Results of Operations" for fiscal 1999.

Due to the depressed gold prices in the past and lack of available funding, SGMC has deferred the start of construction of a gold mill complex and extension

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of existing underground workings. A tourist visitors center has been set up (see below) and leased to a third party for \$1,500 per month plus a 4% gross royalty on revenues. There is one caretaker employee at the Sutter operation. Except for limited infrastructure improvements in 2000, the properties are shut down so far as possible mining operations are concerned. The exploration permits are being kept current as necessary to allow for possible mining activities on the properties in the future.

In 1998 and 1999 the company took impairments (write-downs) in the amounts of \$1,500,000 and \$10,718,800, respectively, of the carrying value of the gold properties. These two impairments wrote off almost 85% of our investment in these properties. As a result of low market prices for gold, we determined that we could not produce gold from these properties at a profit. The impairments taken in 1998 and 1999 resulted in no value for mine exploration, and the remaining assets relating to this property include raw land which is no longer needed for mining activity, and buildings and equipment.

We have not obtained a final feasibility study to support a determination that the Sutter property contains proven or probable reserves of gold.

PROPERTIES. SGMC holds approximately 216 acres of surface and mineral rights (owned), 54 acres of surface rights (owned), 55 acres of surface rights (leased), 154 acres of mineral rights (leased), and 366 acres of mineral rights (owned), all on patented mining claims near Sutter Creek, Amador County, California. The properties are located in the western Sierra Nevada Mountains at from 1,000 to 1,500 feet in elevation; year round climate is temperate. Access is by California State Highway 16 from Sacramento to California State Highway 49, then by paved county road approximately .4 mile outside of Sutter Creek.

Surface and mineral rights holding costs will be approximately \$90,000 from June 1, 2001 through May 31, 2002. Property taxes for fiscal 2001 are estimated to be \$30,000.

The leases are for varying terms, and require rental fees, advance production royalties, real property taxes and insurance.

PERMITS AND FUTURE PLANS. In August 1993, the Amador County Board of Supervisors issued a Conditional Use Permit ("CUP") allowing mining of the SGM and milling of production, subject to conditions relating to land use, environmental and public safety issues, road construction and improvement, and site

reclamation. The permit will allow construction of mine and mill facilities in stages if the project ever gets underway, thereby reducing initial capital outlays. Additional permits (for road work, dust control and construction of mill and other surface improvements) need to be applied for in due course. In August and September 1998, the Amador County Board of Supervisors certified the Final Subsequent Environmental Impact Report ("FSEIR") and approved all of the amendments requested by SGMC. Amendments to the CUP will remove two tailings dams, eliminate the need to use cyanide on-site, and eliminate mine related traffic on two county roads. The certification and decision has been challenged in a lawsuit filed by a local citizens' group, currently under appeal, see "Legal Proceedings."

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VISITORS CENTER. In fiscal 2000, SGMC spent approximately \$298,000 for surface infrastructure related to improving access to the mine site, and to a lesser extent tourist related improvements. The visitors center is being operated by a third party. The visitors center is an exhibit of the pictures and memorabilia from mining operations on other properties in the Sutter district in the nineteenth century, and a guided tour of the underground workings at the Lincoln Project. Revenues from this tourist operation were \$105,400 and \$68,400 in fiscal 2001 and 2000, respectively, and are included in "motel, real estate and airport operations" in the consolidated statements of operations included in this report. These revenues offset a majority of costs for holding the Sutter properties.

MOLYBDENUM

As a holder of royalty, reversionary and certain other interests in properties located at Mt. Emmons near Crested Butte, Colorado, USE and Crested are entitled to receive annual advance royalties of 50,000 pounds of molybdenum, or cash equivalent. AMAX Inc. (which was acquired by Cyprus Minerals Company and was renamed Cyprus Amax Minerals Company in November 1993 and was acquired later by Phelps Dodge) delineated a deposit of molybdenum containing approximately 146,000,000 tons of mineralization averaging 0.43% molybdenum disulfide on the properties of USE and Crested.

Advance royalties are paid in equal quarterly installments until: (i) commencement of production; (ii) failure to obtain certain licenses, permits, etc., that are required for production; or (iii) AMAX's return of the properties to USE and Crested. The advance royalty payments reduce the operating royalties (6% of gross production proceeds) which would otherwise be due out of production. There is no obligation to repay the advance royalties if the property is not placed in production. Phelps Dodge ceased making the quarterly installments in July 2001.

The Agreement with AMAX also provides that USE and Crested receive \$2,000,000 if the Mt. Emmons properties are put into production and, in the event AMAX sells its interest in the properties, USE and Crested are to receive 15% of the first \$25,000,000 received by AMAX. USE and Crested have asserted that the acquisition of Cyprus Amax by Phelps Dodge would entitle USE and Crested to such payment, and that position has been presented to Phelps Dodge, the successor company to Cyprus Amax. This position has been rejected by Phelps Dodge and USE and Crested are considering remedies. USE recognized \$108,500, \$132,600 and \$150,600 of revenues in fiscal 2001, 2000 and 1999 related to this royalty interest.

AMAX Inc. and its successor companies have sought to put the Mt. Emmons molybdenum property into production for 20 years. Due to local opposition to mining (the property is close to the Crested Butte, Colorado recreational resort area) and AMAX's successors' failure to diligently pursue obtaining the permits needed to start mining, we know of no plans at this time to put the property into production.

OIL AND GAS

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FORT PECK LUSTRE FIELD (MONTANA). We operate a small oil production facility (three wells) at the Lustre Oil Field on the Ft. Peck Indian Reservation in northeastern Montana. We receive a fee based on oil produced. This fee and other assets of the Company collateralize a \$750,000 line of credit from a bank.

MOTEL, REAL ESTATE AND AIRPORT OPERATIONS.

We own varying interests, alone and with Crested, in affiliated companies engaged in real estate, and other commercial businesses. The affiliated organizations include Western Executive Air, Inc. ("WEA") and Canyon Homesteads, Inc. (through Plateau). Activities of these and other subsidiaries in the business sectors include ownership and management of a commercial office building, the townsite of Jeffrey City, Wyoming and the townsite, motel, convenience store and other commercial facilities in Ticaboo, Utah.

WYOMING. The Company and Crested own a 14-acre tract in Riverton, Wyoming, with a two-story 30,400 square foot office building (including underground parking). The first floor is rented to affiliates, nonaffiliates and government agencies; the second floor is occupied by the Company and Crested. The property is mortgaged to the WDEQ as security for future reclamation work on the Sheep Mountain Crooks Gap uranium properties.

The Company and Crested (through WEA) also own a fixed base aircraft operation, with fuel sales, and aircraft maintenance, at the Riverton Regional Airport, including a 10,000 square foot aircraft hangar and 7,000 square feet of associated offices and facilities. This operation is located on land leased from the City of Riverton for a term ending December 16, 2005, with an option to renew on mutually agreeable terms for five years.

The Company and Crested also own 17 semi-developed lots on 26.8 acres and 63 acres of undeveloped land near the Riverton Regional Airport, and three mountain sites covering 16 acres in Fremont County, Wyoming.

USECC owned various buildings, 290 city lots and/or tracts and other properties at the Jeffrey City townsite in south-central Wyoming, where about 130 people presently live. USECC sold these properties during May 2001.

In Riverton, Wyoming, the Company owns four city lots and a 9-acre tract with improvements including two smaller office buildings and two other buildings with 12,000 square feet of office facilities, and repair and maintenance shops containing 8,000 square feet.

COLORADO. In connection with the AMAX transaction on the Mt. Emmons molybdenum properties near Crested Butte, Colorado, USECC acquired an option from AMAX (later Cyprus Amax) to purchase approximately 57 acres for \$200,000 in Mountain Meadows Business Park, Gunnison, Colorado. See "Minerals - Molybdenum" above. The property was zoned commercial and industrial, and is adjacent to Western State College. In fiscal 1995, USECC and Cyprus Amax agreed to exercise the option by USE and Crested agreeing to forego six quarters of advance royalties from Cyprus Amax (the option purchase price was \$200,000), plus payment of certain expenses i.e. real property taxes from 1987 and other expenses amounting to \$19,358. Thereafter, USE (together with Crested) signed option agreements with Pangolin Corporation, a Park City, Utah developer, for sale of the 57 acres, and a separate parcel owned in Gunnison County, Colorado.

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Although initial payments on the option agreements were received, the developer is in default on the balance. In July 1998, the Company filed a lawsuit seeking recovery of the balance owing on promissory notes and contracts. See "Item 3 - Legal Proceedings."

UTAH PROPERTIES. Canyon Homesteads, Inc. (a Plateau subsidiary) owns a majority interest in a joint venture which holds the Ticaboo Townsite in Ticaboo, Utah (see "Minerals - Uranium - Shootaring Canyon Mill - Ticaboo Townsite" above). In fiscal 1995, USE acquired the minority interest in the joint venture from a nonaffiliate.

The motel, real estate and airport operations are not dependent upon a single customer, or a few customers, the loss of which would have a materially adverse effect on the Company.

RESEARCH AND DEVELOPMENT

No research and development expenditures have been incurred, either on the company's account or sponsored by customers, during the past three fiscal years.

ENVIRONMENTAL

GENERAL. Operations are subject to various federal, state and local laws and regulations regarding the discharge of materials into the environment or otherwise relating to the protection of the environment, including the Clean Air Act, the Clean Water Act, the Resource Conservation and Recovery Act ("RCRA"), and the Comprehensive Environmental Response Compensation Liability Act ("CERCLA"). With respect to mining operations conducted in Wyoming, Wyoming's mine permitting statutes, Abandoned Mine Reclamation Act and industrial development and siting laws and regulations also impact us. Similar laws and regulations in California affect SGMC operations and Utah laws and regulations effect Plateau's operations.

Management believes the Company complies in all material respects with existing environmental regulations.

As of May 31, 2001, we have recorded estimated reclamation obligations of \$8,906,800. We anticipate that the reclamation efforts may not be required to be started for many years, and that when started, paying for those reclamation efforts will occur over several years. For further information on the approximate reclamation costs (decommissioning, decontamination and other reclamation efforts for which we are primarily responsible or potentially responsible), see note K to the consolidated financial statements included with this report.

CROOKS GAP. An inoperative ion exchange facility at Crooks Gap currently holds a NRC license for possession of uranium operations byproducts. USE applied to the NRC for permission to decommission and decontaminate the plant, and to dispose low level waste into the Sweetwater Mill tailings cell, which is currently underway and is anticipated to be completed in September 2001.

OTHER ENVIRONMENTAL COSTS. Actual costs for compliance with environmental laws may vary considerably from estimates, depending upon such factors as changes in environmental laws and regulation (e.g., the new Clean Air Act), and conditions encountered in minerals exploration and mining. USE does not anticipate that expenditures to comply with laws regulating the discharge of materials into the environment, or which are otherwise designed to protect the

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environment, will have any substantial adverse impact on the competitive position of the Company.

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EMPLOYEES

As of August 17, 2001, USE had approximately 55 full-time employees. Crested uses approximately 50 percent of the time of USE employees, and reimburses USE on a cost reimbursement basis.

MINING CLAIM HOLDINGS

TITLE. Nearly all the uranium mining properties held by the GMMV, USE, USECC and Plateau are on federal unpatented claims. Unpatented claims are located upon federal public land pursuant to procedure established by the General Mining Law. Requirements for the location of a valid mining claim on public land depend on the type of claim being staked, but generally include discovery of valuable minerals, erecting a discovery monument and posting thereon a location notice, marking the boundaries of the claim with monuments, and filing a certificate of location with the county in which the claim is located and with the BLM. If the statutes and regulations for the location of a mining claim are complied with, the locator obtains a valid possessory right to the contained minerals. To preserve an otherwise valid claim, a claimant must also pay certain rental fees annually to the federal government (currently \$100 per claim) and make certain additional filings with the county and the BLM. Failure to pay such fees or make the required filings may render the mining claim void or voidable. Because mining claims are self-initiated and self-maintained, they possess some unique vulnerabilities not associated with other types of property interests. It is impossible to ascertain the validity of unpatented mining claims solely from public real estate records and it can be difficult or impossible to confirm that all of the requisite steps have been followed for location and maintenance of a claim. If the validity of an unpatented mining claim is challenged by the government, the claimant has the burden of proving the present economic feasibility of mining minerals located thereon. Thus, it is conceivable that during times of falling metal prices, claims which were valid when located could become invalid if challenged.

RMG's properties and mineral leases of BLM, state and fee lands require annual cash payments of approximately \$233,000 during fiscal 2002. RMG is obligated for \$48,900 of this amount to keep the leases in effect.

PROPOSED FEDERAL LEGISLATION. The U.S. Congress has, in legislative sessions in recent years, actively considered several proposals for major revision of the General Mining Law, which governs mining claims and related activities on federal public lands. If any of the recent proposals become law, it could result in the imposition of a royalty upon production of minerals from federal lands and new requirements for mined land reclamation and other environmental control measures. It remains unclear whether the current Congress will pass such legislation and, if passed, the extent such new legislation will affect existing mining claims and operations. The effect of any revision of the General Mining Law on operations cannot be determined conclusively until such revision is enacted; however, such legislation could materially increase the carrying costs of mineral properties which are located on federal unpatented mining claims, and could increase both the capital and operating costs for such projects and impair the ability to hold or develop such properties.

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ITEM 3. LEGAL PROCEEDINGS

Material pending proceedings are summarized below. Other proceedings which were pending in fiscal 2001 have been settled or otherwise finally resolved.

SHEEP MOUNTAIN PARTNERS ARBITRATION/LITIGATION

In 1991, disputes arose between USE/Crested, and Nukem, Inc. and its subsidiary Cycle Resource Investment Corp. ("CRIC"), concerning the formation and operation of the Sheep Mountain Partners

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partnership for uranium mining and marketing, and activities of the parties outside SMP. Arbitration proceedings were initiated by CRIC in June 1991 and in July 1991, USECC filed a lawsuit against Nukem, CRIC and others in the U.S. District Court (District of Colorado) in Civil No. 91B1153. Later, USECC filed another suit for the standby costs at the SMP mines against SMP in the Colorado State Court. The Federal Court stayed both the arbitration proceedings and the State Court case. In February 1994, all of the parties agreed to exclusive and binding arbitration of the disputes before the American Arbitration Association ("AAA"), for which the legal claims made by both sides included fraud and misrepresentation, breach of contract, breach of duties owed to the SMP partnership, and other claims.

The AAA panel (the "Panel") entered an Order and Award (the "Order") in April 1996 and clarified the Order on July 3, 1996, finding generally in favor of USE and Crested on certain of their claims (including the claims for reimbursement for standby maintenance expenses and profits denied SMP in Nukem's trading of uranium), and in favor of Nukem/CRIC and against USE and Crested on certain other claims, and imposing a constructive trust in favor of Sheep Mountain Partners on uranium contracts Nukem entered into to purchase uranium from CIS republics. USECC filed a petition for confirmation of the Order and on June 30, 1997, and the U.S. District Court confirmed the Order in its Second Amended Judgment (the "Judgment"). Thereafter, Nukem/CRIC appealed the Judgment to the 10th Circuit Court of Appeals ("CCA").

A three judge panel of the 10th CCA issued an Order and Judgment on October 22, 1998, which unanimously affirmed the Federal District Court's Second Amended Judgment without modification. The ruling affirmed (i) the imposition of a constructive trust in favor of SMP on Nukem's rights to purchase CIS uranium, the uranium acquired pursuant to those rights, and the profits therefrom; and (ii) the damage award against Nukem/CRIC. As a result of the ruling of the 10th CCA, USE and Crested received an additional \$6,077,264 (including interest and court costs) from Nukem in February 1999 for a total net monetary award of \$15,468,625 in the arbitration/litigation, and equitable relief in the form of USE's and Crested's interest in SMP, which holds the constructive trust over the CIS contracts. Nukem/CRIC filed two motions for entry of final satisfaction of Judgment. The U.S. District Court denied both motions, Nukem again appealed to the 10th CCA, which again affirmed the District Court's ruling, and held that Nukem/CRIC had not demonstrated that the Judgment had been satisfied because they had not provided USECC with an accounting of the partnerships assets.

In February 2001, the U.S. District Court appointed a Special Master to determine the amounts, if any, owed by Nukem to SMP pursuant to the constructive trust. The Special Master entered an Order on July 2, 2001 regarding the formulation of an accounting plan. The District Court has set a hearing for October 5, 2001 on the status of the accounting.

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CONTOUR DEVELOPMENT LITIGATION

On July 28, 1998, USE filed a lawsuit in the United States District Court, Denver, Colorado, Case No. 98WM1630, against Contour Development Company, L.L.C. and entities and persons associated with Contour Development Company, L.L.C. (together, "Contour") seeking compensatory and consequential damages of more than \$1.3 million from the defendants for dealings in real estate owned by USE and Crested in Gunnison, Colorado. The Contour defendants asserted a counterclaim asking for payment of attorneys fee and costs. Discovery has been completed and the final pretrial conference is scheduled for October 2, 2001, when the court will schedule the trial date. Trial is expected in early 2002.

See "Business - Commercial Operations - Real Estate and Other Commercial Operations - Colorado Properties" above.

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SGMC LITIGATION

In 1993, Amador County issued a conditional use permit ("CUP") to allow SGMC to develop the SGM near the town of Sutter Creek, Amador County, California. A number of conditions were attached to the original CUP which accommodated local citizen and government agency concerns about noise, waste disposal, traffic and other aspects of the proposed mining operation.

In 1997 and 1998, SGMC proposed amendments to the CUP for a new design of the SGM which would lower its environmental impact by reducing traffic, potentially eliminating the use of cyanide on-site, and removing two large tailings dams which would have been built to hold mine and mill waste. The new design also would significantly reduce capital and operating costs for the mine/mill complex, but cover more land for waste disposal and other purposes. The certification and approval by the Amador County Planning Commission of the Final Subsequent Environmental Impact Report ("FSEIR") and CUP amendments on July 14, 1998 was appealed (by a local citizens project opposition group) to the Amador County Board of Supervisors. In August and September 1998, the Board of Supervisors certified the FSEIR and approved the amendments to the CUP.

On September 28, 1998 a lawsuit was filed in Amador County Superior Court, California (Case No. 98 CV 3298) by Concerned Citizens of Amador County as plaintiffs, against the County of Amador and the Amador County Board of Supervisors, and against SGMC as a real party in interest. The lawsuit challenges the actions of Amador County and its Board of Supervisors in certifying the FSEIR and approving the amended CUP. A hearing was held on June 7, 1999 and the Court denied all claims by the Plaintiffs Concerned Citizens who appealed the decision. Oral arguments were made to the appellate court on August 20, 2001.

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

On December 8, 2000, the shareholders approved the following matter at the annual shareholders' meeting held at the company's offices at 877 North 8th West, Riverton, WY

Re-election of directors:

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| Name of Director ----- | Votes For ----- | Votes Against ----- | Abstain ----- | Votes Withheld ----- |
|---------------------------|--------------------|------------------------|------------------|-------------------------|
| John L. Larsen | 8,435,903 | 3,285 | 61,359 | 900 |
| Keith G. Larsen | 8,435,903 | 3,285 | 61,359 | 3,731 |

INFORMATION CONCERNING EXECUTIVE OFFICERS WHO ARE NOT DIRECTORS.

The following are the two executive officers of USE as of the date of this Form 10-K/A; these persons devote their full time to the Company's business. Max Evans was Secretary for USE and President of Crested, until his death on February 28, 2002.

ROBERT SCOTT LORIMER, age 50, has been the Chief Accounting Officer for both USE and Crested for more than the past five years. Mr. Lorimer also has been Chief Financial Officer for both these companies since May 25, 1991, their Treasurer since December 14, 1990, and Vice President Finance since April 1998. He serves at the will of each board of directors. There are no understandings between Mr. Lorimer and any other person, pursuant to which he was named as an officer, and he has no family relationship with any of the other executive officers or directors of USE or Crested. During the past five years, Mr. Lorimer has not been involved in any Reg. S-K Item 401(f) listed proceeding.

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DANIEL P. SVILAR, age 72, has been General Counsel for USE and Crested for more than the past five years. He also has served as Secretary and a director of Crested, and Assistant Secretary of USE. His positions of General Counsel to, and as officers of the companies, are at the will of each board of directors. There are no understandings between Mr. Svilar and any other person pursuant to which he was named as officer or General Counsel. He has no family relationships with any of the other executive officers or directors of USE or Crested, except his nephew Nick Bebout is a USE director. During the past five years, Mr. Svilar has not been involved in any Reg. S-K Item 401(f) proceeding.

PART II

ITEM 5. MARKET FOR COMMON SHARES AND RELATED STOCKHOLDER MATTERS

(a) Market Information

Shares of USE common stock are traded on the over-the-counter market, and prices are reported on a "last sale" basis by the National Market System ("NMS") of the National Association of Securities Dealers Automated Quotation System ("Nasdaq"). The range by quarter of high and low sales prices is set forth below for fiscal 2001 and 2000.

| | High ---- | Low --- |
|-----------------------------------|--------------|------------|
| Fiscal year to ended May 31, 2001 | | |
| First quarter ended 8/31/00 | \$ 3.00 | \$ 1.75 |
| Second quarter ended 11/30/00 | 3.375 | 1.75 |
| Third quarter ended 2/28/01 | 4.00 | 2.00 |
| Fourth quarter ended 5/31/01 | 6.25 | 3.563 |

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Fiscal year ended May 31, 2000

| | | |
|-------------------------------|---------|---------|
| First quarter ended 8/31/99 | \$ 5.09 | \$ 3.25 |
| Second quarter ended 11/30/99 | 4.50 | 3.19 |
| Third quarter ended 2/29/00 | 3.88 | 3.13 |
| Fourth quarter ended 5/31/00 | 3.63 | 2.06 |

(b) Holders

(1) At August 17, 2001, the closing bid price was \$4.23 per share and there were approximately 733 shareholders of record. As of August 17, 2001, we have 7,202,697 shares of common stock issued and outstanding, which do not include shares owned by our subsidiaries or shares in officers' and directors' names that are subject to forfeiture.

(2) Not applicable.

(c) We have not paid any cash dividends with respect to common stock. There are no contractual restrictions on our present or future ability to pay cash dividends, however, we intend to retain any earnings in the near future for operations.

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ITEM 6. SELECTED FINANCIAL DATA.

The following tables show certain selected historical financial data for USE for the five years ended May 31, 2001. The selected financial data is derived from and should be read with the financial statements for USE included in this Report.

| | May 31, | | | |
|---------------------------|--------------|--------------|---------------|---------------|
| | 2001 | 2000 | 1999 | 1998 |
| Current assets | \$ 3,330,000 | \$ 3,456,800 | \$ 12,718,900 | \$ 14,301,000 |
| Current liabilities | 2,396,700 | 6,617,900 | 5,355,600 | 6,062,100 |
| Working capital (deficit) | 933,300 | (3,161,100) | 7,363,300 | 8,238,900 |
| Total assets | 30,465,200 | 30,876,100 | 33,391,000 | 45,019,100 |
| Long-term obligations(1) | 14,981,500 | 14,025,200 | 14,526,900 | 14,468,600 |
| Shareholders' equity | 7,320,600 | 4,683,800 | 10,180,300 | 17,453,500 |

(1) Includes \$8,906,800, \$8,906,800, \$8,860,900, \$8,778,800, and \$8,751,800 of accrued reclamation costs on mining properties at May 31, 2001, 2000, 1999, 1998 and 1997, respectively. See Note K of Notes to Consolidated Financial Statements.

For Years Ended May 31,

| 2001 | 2000 | 1999 | 1998 |
|------|------|------|------|
|------|------|------|------|

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| | ----- | ----- | ----- | ----- |
|---|--------------|-----------------|-----------------|--------------|
| Operating revenues | \$ 5,501,600 | \$ 6,888,800 | \$ 3,788,600 | \$ 6,132,600 |
| Loss from continuing operations | (7,029,700) | (11,950,400) | (23,078,300) | (4,984,900) |
| Other income & expenses | 8,730,800 | 802,200 | 7,020,500 | 5,349,900 |
| (Loss) income before minority interests, equity in (loss) income of affiliates, discontinued operations, and income taxes | 1,701,100 | (11,148,200) | (16,057,800) | (365,000) |
| Minority interest in loss (income) of consolidated subsidiaries | 220,100 | 509,300 | 4,468,400 | (772,500) |
| Equity in loss of affiliates | -- | (2,900) | (59,100) | (575,700) |
| Income taxes | -- | -- | -- | -- |
| Discontinued operations net of tax | -- | -- | -- | -- |
| Preferred stock dividends | (150,000) | (20,800) | -- | -- |
| Net (loss) income to common shareholders | \$ 1,771,200 | \$ (10,662,600) | \$ (11,648,500) | \$ (983,200) |

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| | ----- May 31, ----- | | | |
|---|---------------------|---------|---------|---------|
| | 2001 | 2000 | 1999 | 1998 |
| | ----- | ----- | ----- | ----- |
| Per shares financial data | | | | |
| Operating revenues | \$ 0.70 | \$ 0.91 | \$ 0.53 | \$ 0.92 |
| Loss from continuing operations | (0.90) | (1.57) | (3.18) | (0.75) |
| Other income & expenses | 1.11 | 0.11 | 0.93 | 0.80 |
| (Loss) income before minority interests, equity in income (loss) of affiliates, discontinued operations, and income taxes | 0.21 | (1.46) | (2.25) | 0.05 |

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| | | | | |
|--|---------|-----------|-----------|-----------|
| Minority interest in loss (income) of consolidated subsidiaries | .03 | .07 | .63 | (0.12) |
| Equity in loss of affiliates | -- | -- | (0.01) | (0.08) |
| Income taxes | -- | -- | -- | -- |
| Preferred stock dividends | (0.01) | -- | -- | -- |
| Net income (loss) per share, basic | \$ 0.23 | \$ (1.39) | \$ (1.63) | \$ (0.15) |
| Net income (loss) per share diluted | \$ 0.21 | \$ (1.39) | \$ (1.63) | \$ (0.15) |
| Cash dividends per share | \$ -0- | \$ -0- | \$ -0- | \$ -0- |

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

The following is Management's Discussion and Analysis of significant factors which have affected our liquidity, capital resources and results of operations during the periods included in the accompanying financial statements. The discussion contains forward-looking statements that involve risks and uncertainties. Due to uncertainties in our business, actual results may differ materially from the discussion below.

LIQUIDITY AND CAPITAL RESOURCES

During the year ended May 31, 2001, we experienced an increase in working capital of \$4,094,400 consisting mainly as a result of the non-cash revenue recognition of the deferred GMMV purchase option of \$4,000,000. At May 31, 2000, we had a working capital deficit of \$3,161,100 as compared to working capital of \$933,300 at May 31, 2001.

Components of the increase in working capital were increases in accounts receivable trade \$264,300; current portion of long term notes receivable of \$225,000; assets held for resale and other assets of \$137,000; along with decreases in accounts payable of \$279,500; deferred GMMV purchase option of \$4,000,000, and current portion of long-term debt of \$141,700. These increases in working capital were offset by reductions in; cash of \$230,900; accounts receivable affiliates of \$434,700, and inventory of \$87,500, along with an increase in the outstanding balance under the line of credit of \$200,000. Inventories decreased by \$87,500 at May 31, 2002 as a result of certain retail commercial operations in Southern Utah being subcontracted or leased as ongoing concerns to third parties. In connection with these entities' assumption of our retail operations in Southern Utah, the inventories associated with these retail operations were sold to the third parties at cost. These inventories consisted primarily of fuel and convenience store consumable inventories.

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On September 11, 2000, we entered into a settlement agreement with Kennecott relating to a legal dispute between the joint venture partners in the GMMV operations. As a result of this settlement, we received certain GMMV equipment with an approximate value equal to the Company's investment in GMMV of \$727,000; cash payments of \$3,250,000, and the GMMV terminated its deferred GMMV purchase option. In exchange, we forgave our balance due from GMMV of \$367,000 reducing the amounts due from affiliated entities. We used the proceeds to pay our trade creditors and other liabilities; therefore, accounts payable decreased.

Accounts receivable trade at May 31, 2000, consisted primarily of amounts due for contract drilling and construction work. These receivables were collected during the year ended May 31, 2001. This reduction in accounts receivable trade was offset by amounts due from the auction of certain mining and drilling equipment during the last month of the fiscal year ended May 31, 2001. Accounts receivable affiliates were reduced due to the collection of accounts receivable from GMMV and accounts and notes receivable from employees. The reduction of debt from employees consisted of the payment of cash, settlement agreements, and the receipt of 5,000 shares of the Company's common stock which was pledged for the indebtedness. These shares were recorded as treasury shares at the value of the principal portion of the debt reduction.

During the year ended May 31, 2001, we sold our controlling interest in Ruby Mining Company ("Ruby") to Admiralty Corporation ("Admiralty") of Atlanta Georgia. Admiralty has developed technology that differentiates ferrous from non-ferrous metals in sea water. This technology is used to explore for and recover sunken treasures. Admiralty paid us \$100,000 and signed a promissory note for \$225,000 for the purchase of Ruby. At the time of this report, the promissory note was in default but we believe that Admiralty will pay the amount due or we will reach other terms to satisfy the debt. We maintained a 4% ownership position in Ruby by retaining 900,000 shares of its common stock. We continue to be in frequent contact with Admiralty Corporation's management and discuss the collectability of the note. Our management has been assured that the note will be paid when funding is generated by Admiralty. We have also begun to liquidate

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our holdings in the common stock of Ruby. The current market is approximately \$0.18 per share. Any proceeds realized from the sale of the Ruby shares will be first applied against the loan. At such time as the note balance is paid in full, either through the sale of Ruby stock or payments from Admiralty, the remaining payments on the note from Admiralty once the note is paid in full will be recognized as revenue. The sale of the Ruby stock as well as management's discussions with Admiralty provide reasonable assurance that the note will be collected.

Assets held for resale and other assets increased by \$137,000 as a result of increased deferred compensation due to the funding of the 1996 Stock Award Program. Inventories decreased by \$87,500 as of May 31, 2001 as a result of our leasing all of the commercial operations in southern Utah to third parties with the exception of the motel which has no retail inventory. Current portion of long-term debt was reduced by \$141,700 from the proceeds of the sale of certain equipment. The line of credit was drawn down by an additional \$200,000 during fiscal 2001 to finance operations.

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During the year ended May 31, 2001, investing and financing operations generated cash of \$983,500 and \$258,500, respectively while operation activities consumed cash of \$1,472,900, for a net decrease in cash of \$230,900. Other non-cash components of the net profit for the year ended May 31, 2001 were depreciation of \$1,254,000, an impairment on mineral interests of \$123,800 and non-cash compensation of \$501,700, the majority of which was the annual contribution to the Company's ESOP. The net change in assets and liabilities resulted in a \$242,000 decrease of cash.

Although operations resulted in a profit of \$1,771,200, a large portion of this gain was the non-cash transaction of recognizing \$4,000,000 of deferred income from GMMV as other income although we had received the cash in a previous period.

Investing activities provided \$983,500 in cash during the twelve months ended May 31, 2001. Proceeds from the sale of property and equipment provided \$2,608,000. Investment activity in coalbed methane properties used \$1,187,800 net. This net use of cash is a result of (1) RMG purchasing \$2.0 million of coalbed methane properties, (2) RMG spending \$435,600 in property development and (3) the receipt of \$1.3 million from Suncor Energy Natural Gas America, Inc. ("SENGAI"). Please see "Capital Resources." We also purchased various pieces of equipment which used \$311,400 in cash. Interest earned on cash investments held for reclamation was reinvested, which used cash of \$417,700.

Cash was consumed in financing activities as the result of paying \$828,400 on our debt. This reduction of debt was offset by new debt of \$619,100 and additional draw down of the line of credit of \$200,000. The increase in debt during fiscal 2001 was to fund the purchase of drilling and construction equipment and the partial financing of our real estate operations in southern Utah of \$300,000. We also received \$288,400 as a result of our employees exercising options to purchase USE common shares.

We issued 8,532 shares of our restricted common stock valued at \$19,100 during year ended May 31, 2001 as non-cash compensation to our outside directors. We also issued 15,000 shares of our common stock valued at \$70,500 as compensation to a consultant and 53,837 shares of common stock valued at \$288,000 to our employee retirement plan. As a partial retirement of employee debt, we received 5,000 shares of stock valued at \$20,600, which became treasury stock.

CAPITAL RESOURCES

The primary sources of our capital resources are cash on hand; collection of receivables; projected equity financing of our coalbed methane affiliate RMG; production of coalbed methane gas; sale of excess mine, construction and drilling equipment; sale of partial ownership interest in mineral properties; proceeds under the line of credit; receipt of contracted amounts from the sale of interests in coalbed methane properties, and the final determination of the SMP arbitration/litigation. We also will continue to receive revenues from our motel and real estate operations in southern Utah along with airport operations

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in Wyoming.

We currently have a \$750,000 line of credit with a commercial bank. At the time of this report (10-K), this line of credit has been drawn down by \$350,000. We also have a \$500,000 line of credit through our affiliate Plateau Resources. This line of credit is for the development of the Ticaboo town site in southern Utah. Plateau has drawn down this financing facility \$300,000 which is repayable over 10 years. All payments on these lines of credit are current as of the filing date of this report.

Subsequent to May 31, 2001 we received \$796,000 for 199,000 (restricted under rule 144) shares of common stock through a private placement. We also received \$288,400 during fiscal 2001 and \$310,200 during the first quarter of 2002 from employees as they exercised options. We continue to seek equity or industry partner financing for RMG.

We have entered into agreements with two companies to sell a portion of our interest in our coalbed methane properties. The first agreement is an option and farm-in agreement with Suncor Energy Natural Gas America Inc. ("SENGAI"), a subsidiary of Suncor Energy Inc. of Alberta, Canada. SENGAI is obligated to fund \$2,000,000 of a \$2,250,000 drilling program in 112,000 acres in part of our Montana coalbed methane properties. SENGAI, under the agreement, may exercise its option by paying \$3,684,300, of which we would receive \$2,763,200, in February of 2002. Should SENGAI exercise this option it would own a 50% working interest and a 40% net revenue interest in the 112,000 acres. Our interest would be reduced to 12.5% working interest and 10% net revenue interest should SENGAI exercise its option, subject to further reduction to 6.25% and 5% respectively by separate agreement with Carrizo.

We also have entered into a purchase and sale agreement with CCBM, Inc. ("CCBM"), a wholly owned subsidiary of Carrizo Oil & Gas, Inc. of Houston Texas. CCBM signed a promissory note in the amount of \$7,500,000 to purchase a 50% undivided interest in all of our coalbed methane properties. The promissory note bears interest at an annual rate of 8% and is payable at the rate of \$125,000 per month plus interest for forty-one months with a balloon on the forty-second month.

CCBM is also obligated to fund an initial drilling program in the amount of \$5,000,000 of which \$2,500,000 will be credited to RMG's benefit. Of this amount \$250,000 will be committed to satisfy RMG's commitment under the SENGAI drilling program (as well as the remaining obligation under the Quantum agreement). For this advance of funds, CCBM will receive a 50% interest in RMG's interest in those wells drilled under the SENGAI initial drilling program and a 6.25 % working interest, and a 5% net revenue interest in the 112,000 acres which are subject to the SENGAI option. Should SENGAI not exercise its option, CCBM has the option to purchase an additional 18.75% of the total ownership in the 112,000 acres at the

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same price per net acre in the SENGAI agreement. If this occurs both RMG and CCBM would own undivided 25% interests in the 112,000 acres.

We believe that these cash resources will be sufficient to sustain operations during fiscal 2002. We will continue to pursue equity and industry partner financing to fund our portion of RMG's obligations under the drilling programs.

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CAPITAL REQUIREMENTS

The primary requirements for our working capital during fiscal 2002 are expected to be development of coalbed methane properties; the cost of holding our shut down uranium properties; the shut down SGMC properties holding costs, and general and administrative costs. Estimated working capital requirements for the full fiscal year 2002 are \$5.3 million; development and holding costs for coalbed methane properties \$550,000; costs to hold shut down uranium properties and associated real estate assets \$380,000; shut down SGMC properties holding costs \$230,000, and general and administrative costs \$4,140,000. These allocations and estimates may vary depending on the level of acquisition and drilling RMG participates in during the year.

EXPLORATION OF COALBED METHANE PROPERTIES

The majority of the fiscal 2002 exploration costs associated with the coalbed methane properties of RMG has been funded through the SENGAI and CCBM agreements. Under the CCBM purchase and sale agreement, if properties are drilled that are owned 50% by RMG, we may be required to fund the drilling costs for the interest ownership of the remaining non-participating parties. Should we be required to fund any non-participating entities portion of the exploration programs, there is a back-in provision on each property which gives RMG a disproportionate amount of the production revenues until our cost and additional amounts are recovered before the non-participating parties begin to receive production funds.

HOLDING COSTS OF SHUT DOWN URANIUM PROPERTIES

SMP URANIUM PROPERTIES

The holding costs associated with the Sheep Mountain uranium properties were approximately \$33,300 per month during fiscal 2001. We continue to implement cost cutting measures to reduce the holding costs. We are obligated to reclaim the GMIX plant which was used to extract uranium from mine waters. We have begun the process of reclamation and are moving and burying the GMIX plant in the Sweetwater mill tailings cell, which belonged to the GMMV and is now owned by Kennecott. During fiscal 2001, we expended \$16,600. As of the quarter ended February 28, 2002, the reclamation of the GMIX plant has been completed for an additional amount of \$360,000. The company is seeking final approval by the reclamation from the regulatory agencies.

PLATEAU RESOURCES URANIUM PROPERTIES

Plateau owns the Ticaboo townsite, motel, convenience store, boat storage, restaurant and lounge. Prior to fiscal 2002, we operated all of these entities. A decision was made to lease out all but the motel operations during fiscal 2002. This decision relieved us of the obligation and expense of employees, inventory and risk of loss for the leased operations.

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Additionally, Plateau owns and maintains the Tony M uranium property and Shootaring Canyon Uranium Mill. The uranium property and mill are both shut down. We are pursuing alternative uses for these properties including the potential sale of the uranium mill.

SUTTER GOLD MINING COMPANY Properties

Due to the depressed market price of gold, further work on the SGMC properties has been deferred into the future. SGMC developed a tourism business to cover the holding costs of the properties until such time as the price for gold recovers. A decision was made to lease out the tourism business to a third party. The revenues received from the lease cover a majority of our holding costs associated with the mine shop and mineral leases. We have one employee at the SGMC properties to preserve the core property land and equipment. SGMC is in the process of evaluating the potential of selling certain of the non essential land positions that it has acquired in developing a mine plan.

DEBT PAYMENTS

Debt to non-related parties at May 31, 2001 was \$2,294,500 as compared to \$1,184,200 at May 31, 2000. The increase in debt to non-related parties consists primarily of debt due on the financing of equipment and our corporate aircraft which was previously leased. The balance of the debt to non-related parties, is for the purchase of land and buildings by SGMC. All payments on the debt are current.

At May 31, 2001, the Company had borrowed \$850,000 of its line of credit. As of the date of the Form 10-K, the outstanding amount under the line of credit was \$350,000. This debt is secured by the pledge of equipment and real estate assets of the Company.

FEDERAL INCOME TAX ISSUES

The Internal Revenue Service ("IRS") audited our books and records for the fiscal years ended May 31, 1993, 1994, 1995 and 1996. We have attended appeals hearings in the Denver office of the IRS and have resolved all issues raised in the IRS audits. Pursuant to these settlements, there were no material taxes due as a result of the IRS audit. The fiscal years through May 31, 1996 are therefore considered closed.

RECLAMATION COSTS

With the exception of any amounts that may become needed in excess of the cash bond on the GMIX reclamation project, it is not anticipated that any of our working capital will be used in fiscal 2002 for the reclamation of any of its mineral property interests. The reclamation obligations are long term and are either bonded through the use of cash bonds or the pledge of assets.

The reclamation liability on the Plateau uranium properties is \$7,382,100 which is reflected on the Balance Sheet as a reclamation liability. This liability is fully funded by cash investments which are recorded as long term restricted assets.

The reclamation costs of the Sheep Mountain properties are \$1,496,800 and are covered by a reclamation bond which is secured by a pledge of certain of our real estate assets.

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The reclamation of SGMC gold properties is approximately \$27,900. This reclamation obligation is bonded with a cash bond.

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RESULTS OF OPERATIONS

FISCAL 2001 COMPARED TO FISCAL 2000

Revenues:

Revenues during fiscal 2001 decreased \$1,387,200 from revenues for the previous year to \$5,501,600. This decrease was primarily as a result of a decrease in contract drilling and construction and motel, real estate and airport operations revenues. These decreases were offset by increases in mineral sales and management fees.

During fiscal 2001, we received \$108,500 from advance royalties, and \$334,300 from uranium contract deliveries and the sale of a uranium delivery contract. The uranium delivered under this contract was purchased from the market as our uranium mines are shut down. During fiscal 2000 we recorded \$132,600 from advance royalties.

Contract drilling and construction revenues decreased by \$1,346,300 during the fiscal year 2001 due to reduced contract work for third parties. Revenues from motel, real estate and airport operations decreased from \$2,734,800 at May 31, 2000 to \$2,222,400 at May 31, 2001. This decrease is as result of the mine tour at SGMC and the boat storage, restaurant and convenience store operations being leased out by Plateau during fiscal 2001.

Management fees increased \$161,300 to \$597,800 during fiscal 2001. This increase was due to RMG operations on which we receive a management fee.

Costs and Expenses:

Costs and expenses decreased by \$6,307,900 during fiscal 2001 to \$12,531,300 from \$18,839,200 during the previous year. This reduction in costs and expenses came as a result of reduced contract drilling/ construction operation expense of \$2,428,700; reduced motel, real estate and airport operations expense of \$151,100; provision for doubtful accounts of \$708,600; and general and administrative costs and expenses of \$3,805,900. These reductions in costs and expenses were offset by increases in mineral holding costs of \$662,600; and abandonment of mining equipment of \$123,800.

Contract drilling and construction costs and expenses were reduced as a result of the curtailment of contract operations for third parties during fiscal 2001. General and administrative costs during fiscal 2000 were significantly higher than those experienced during fiscal 2001 due to a non-cash charge to

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operations of \$3,139,100 as a result of the issuance of common shares of RMG stock below the market. Other reductions in General and Administrative costs and expenses during fiscal 2001 were related to a reduction of staff.

Operations for the fiscal year ended May 31, 2001, resulted in earnings of \$1,771,200 or \$0.21 per share fully diluted as compared to a loss of \$10,662,600 or \$1.39 per share fully diluted for the fiscal year ended May 31, 2000.

Other Income and Expenses:

As a result of the settlement of the Kennecott litigation, \$7,132,800 was recorded as revenue during fiscal 2001. This revenue has two components: (1) Non-cash revenues as a result of the recognition of

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\$4,000,000 of a deferred GMMV purchase option payment that was received in 1997 and (2) the receipt of cash from Kennecott as a result of the settlement, \$3,132,800 - net of accounts receivable from GMMV.

During the fiscal 2001, we recognized a gain of \$1,163,600 from the sale of equipment that was determined to be surplus. One component of this amount was the sale of certain GMMV assets that were distributed to the Company upon the resolution of the GMMV litigation. The other main components of this increase are the final royalty payment received from the sale of The Brunton Company of \$233,000, and the sale of a real estate property in Colorado of \$264,600.

FISCAL 2000 COMPARED TO FISCAL 1999

Revenues:

During fiscal 2000, the Company recognized revenues from advance royalties on its molybdenum property, \$132,600, contract drilling and construction work in the coalbed methane industry, \$3,584,900, motel, real estate and airport operations, \$2,734,800. The Company also recognized revenues from management fees of \$436,500.

Total revenues during fiscal 2000 were \$6,888,800, an increase of \$3,100,200 from revenues of \$3,788,600 in fiscal 1999. This increase was as a result of \$3,584,900 of contract drilling and construction revenues being recorded during fiscal 2000. There were no similar revenues in fiscal 1999. This increase in revenues was offset by decreased revenues from royalties, mineral sales of \$87,600, motel, real estate and airport operations of \$148,000 and management fees of \$231,100.

The decrease in mineral sales is as a result of the Company recognizing revenues of \$87,600 from the sale of uranium under a SMP contract during fiscal 1999. No revenues were recognized from sales of uranium during fiscal 2000. All minerals sold under contracts were purchased on the open market as all of the Company's properties are shut down. This decrease in uranium sales plus the a decrease in the market price for molybdenum, which reduced the advance royalty from Cyprus Amax during fiscal 2000 by \$18,000, accounted for the reduction in

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mineral sales revenues.

Motel, real estate and airport operations decreased by \$148,000 as a result of reduced equipment rental revenues received by the Company for the rental of equipment to the GMMV during fiscal 2000 as compared to fiscal 1999. The reduced activity at GMMV during fiscal 2000 also was the main contributor to the reduced management fee revenue when compared with fiscal 1999.

Operating Costs and Expenses:

Costs and expenses were reduced in fiscal 2000 by \$8,027,700 to \$18,839,200 from \$26,866,900 during fiscal 1999. This reduction was primary as a decrease in the impairment of mineral properties of \$13,224,400. No impairment of mineral properties was taken during fiscal 2000. During fiscal 1999, the Company determined that an impairment should be taken on the SGMC assets of \$10,718,300 and the Yellow Stone Fuels Corp. ("YSFC") assets of \$2,506,100. The impairment of the SGMC and YSFC assets related to the recoverability of the Company's investment in the mineral properties and equipment based on the then market prices for gold and uranium. Other decreases in costs and expenses were a \$51,600 reduction in motel, real estate and airport operations as a result of cost cutting efforts.

Increases in costs and expenses during fiscal 2000 over fiscal 1999 are \$332,300 in mineral holding costs; \$4,164,400 in contract drilling and construction operations.

Costs and expenses in mineral operations during fiscal 2000 increased as a result of increased activities for the Company's own account where mineral operations in previous years were associated primary with joint ventures that either reimbursed a portion or all of the costs. Contract drilling and construction costs recorded during fiscal 2000 have no comparative costs and expenses during fiscal 1999. These costs include all labor, equipment operating and repair expenses and other costs associated with contract drilling and construction. Prior to fiscal 2000, there were no contract drilling and construction operations.

General and Administrative costs and expenses increased by \$408,000 during fiscal 2000. Included in this increase is non-cash compensation of \$3,139,100 which was as a result of the issuance of common shares of RMG stock below market. The increase in General and Administrative costs and expenses was offset by reductions of General and Administrative costs and expenses at SGMC and other Company operations resulting in a net decrease in General and Administrative costs and expenses of \$2,731,100.

Other Income and Expenses

During fiscal 1999, we recognized \$6,077,300 in income from a partial settlement of certain SMP litigation matters. There was no similar income recognized during fiscal 2000.

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Operations resulted in a loss of \$10,622,600 or \$1.39 per share fully diluted as compared to a loss of \$11,648,500 or \$1.63 per share fully diluted during fiscal 1999.

FUTURE OPERATIONS

We have generated losses in two of the last three years as a result of holding costs and permitting activities in the mineral segment along with impairments of mineral assets. We have maintained some of our investments in gold and uranium properties that continue to generate no operating revenues. These properties require expenditures for items such as permitting, care and maintenance, holding fees, corporate overhead and administrative expenses. Success in the minerals industry is dependent on the price that a producer can receive for its minerals. We cannot predict what the long term price for gold and uranium will be and therefore cannot predict when, or if, we will generate net income from these operations. We believe we have sufficient capital resources to maintain our mineral properties on a standby basis through fiscal 2002. Development activities of the mineral properties and expansion of commercial operations are dependent on the Company obtaining equity financing or commercial loans. It may also be necessary to generate cash through the sale of equipment or other assets.

At May 31, 2001 we are committed to be in the coalbed methane business well into the future. Uranium prices and market projections are being evaluated. Decisions to liquidate part or all of the Company's uranium holdings are being considered. We are also evaluating its commitment to the gold business and at what time the price for gold may recover.

EFFECTS OF CHANGES IN PRICES

Mineral operations are significantly affected by changes in commodity prices. As prices for a particular mineral increase, prices for prospects for that mineral also increase, making acquisitions of such properties costly, and sales advantageous. Conversely, a price decline facilitates acquisitions of properties containing that mineral, but makes sales of such properties more difficult. Operational impacts of changes in mineral commodity prices are common in the mining industry.

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NATURAL GAS. Our decisions to expand into the coalbed methane gas industry were predicated on the projections for natural gas prices.

URANIUM AND GOLD. Changes in the prices of uranium and gold will affect our operational decisions the most. Currently, both gold and uranium are at historical low prices. We continually evaluate market trends and data. We do not plan to go forward with any additional work on our uranium and gold properties until the market price for these metals increase and remain at profitable levels.

MOLYBDENUM AND OIL. Changes in prices of molybdenum and petroleum are not expected to materially affect our operations during fiscal 2002. A significant and sustained increase in demand for molybdenum would be required for the development of the Mt. Emmons properties by Phelps Dodge since it has another

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producing molybdenum mine.

ITEM 8. FINANCIAL STATEMENTS

Financial statements meeting the requirements of Regulation S-X for the Company follow immediately.

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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To U.S. Energy Corp.:

We have audited the accompanying consolidated balance sheet of U.S. ENERGY CORP. (a Wyoming corporation) AND SUBSIDIARIES as of May 31, 2001, and the related consolidated statements of operations, shareholders' equity and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of U.S. Energy Corp. and subsidiaries as of May 31, 2001, and the results of their operations and their cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

GRANT THORNTON LLP

Denver, Colorado,
July 27, 2001

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

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To U.S. Energy Corp.:

We have audited the accompanying consolidated balance sheet of U.S. ENERGY CORP. (a Wyoming corporation) AND SUBSIDIARIES as of May 31, 2000, and the related consolidated statements of operations, shareholders' equity and cash flows for each of the two years in the period ended May 31, 2000. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of U.S. Energy Corp. and subsidiaries as of May 31, 2000, and the results of their operations and their cash flows for each of the two years in the period ended May 31, 2000, in conformity with accounting principles generally accepted in the United States.

ARTHUR ANDERSEN LLP

Denver, Colorado,
September 11, 2000

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U.S. ENERGY CORP. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

ASSETS

| | May 31, | |
|-------------------------------------|------------------------|---------------|
| | ----- 2001 ----- | 2000 ----- |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$ 685,500 | \$ 916,400 |
| Accounts receivable: | | |
| Trade, net of allowance of \$27,800 | 1,319,300 | 1,055,000 |

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| | | |
|--|---------------|---------------|
| Affiliates | 74,200 | 508,900 |
| Current portion of long-term notes | 225,000 | -- |
| Assets held for resale and other | 983,800 | 846,800 |
| Inventory | 42,200 | 129,700 |
| | ----- | ----- |
| Total current assets | 3,330,000 | 3,456,800 |
| INVESTMENTS AND ADVANCES: | | |
| Affiliates | 16,200 | 9,600 |
| Restricted investments | 9,778,700 | 9,361,000 |
| | ----- | ----- |
| Total investments and advances | 9,794,900 | 9,370,600 |
| PROPERTIES AND EQUIPMENT: | | |
| Land | 1,771,800 | 1,999,000 |
| Buildings and improvements | 8,425,400 | 8,819,800 |
| Machinery and equipment | 5,536,900 | 10,386,200 |
| Proved oil properties, full cost method | 1,773,600 | 1,773,600 |
| Unproved coalbed methane properties, excluded from amortization | 5,881,700 | 4,727,200 |
| | ----- | ----- |
| Total property and equipment | 23,389,400 | 27,705,800 |
| Less-Accumulated depreciation, depletion and amortization | (7,285,100) | (10,948,900) |
| Net property and equipment | 16,104,300 | 16,756,900 |
| OTHER ASSETS: | | |
| Accounts and notes receivable: | | |
| Real estate sales | 42,400 | 58,600 |
| Employees | 180,300 | 295,200 |
| Deposits and other | 1,013,300 | 938,000 |
| Total other assets | 1,236,000 | 1,291,800 |
| | ----- | ----- |
| Total assets | \$ 30,465,200 | \$ 30,876,100 |
| | ===== | ===== |

The accompanying notes to consolidated financial statements
are an integral part of these statements.

U.S. ENERGY CORP. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
LIABILITIES AND SHAREHOLDERS' EQUITY

May 31,

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| | 2001 | 2000 |
|--|---------------|---------------|
| | ----- | ----- |
| CURRENT LIABILITIES: | | |
| Accounts payable and accrued expenses | \$ 1,404,300 | \$ 1,683,800 |
| Deferred GMMV purchase option | -- | 4,000,000 |
| Current portion of long-term debt | 142,400 | 284,100 |
| Line of credit | 850,000 | 650,000 |
| | ----- | ----- |
| Total current liabilities | 2,396,700 | 6,617,900 |
| LONG-TERM DEBT | 2,152,100 | 900,100 |
| RECLAMATION LIABILITY | 8,906,800 | 8,906,800 |
| OTHER ACCRUED LIABILITIES | 2,777,800 | 3,073,500 |
| DEFERRED TAX LIABILITY | 1,144,800 | 1,144,800 |
| MINORITY INTERESTS | 1,177,800 | 1,124,600 |
| COMMITMENTS AND CONTINGENCIES | | |
| FORFEITABLE COMMON STOCK, | | |
| \$.01 par value; 433,788 and 396,608 | | |
| shares issued, forfeitable until earned | 2,748,600 | 2,584,600 |
| PREFERRED STOCK, | | |
| \$.01 par value; 1,000 shares authorized, | | |
| 200 shares issued and outstanding | 1,840,000 | 1,840,000 |
| SHAREHOLDERS' EQUITY: | | |
| Common stock, \$.01 par value; 20,000,000 shares | | |
| authorized; 8,989,047 and 8,763,155 | | |
| shares issued, respectively | 90,000 | 87,700 |
| Additional paid-in capital | 38,681,600 | 37,797,700 |
| Accumulated deficit | (28,300,000) | (30,071,200) |
| Treasury stock at cost, 949,725 and 944,725 | | |
| shares, respectively | (2,660,500) | (2,639,900) |
| Unallocated ESOP contribution | (490,500) | (490,500) |
| | ----- | ----- |
| Total shareholders' equity | 7,320,600 | 4,683,800 |
| | ----- | ----- |
| Total liabilities and shareholders' equity | \$ 30,465,200 | \$ 30,876,100 |
| | ===== | ===== |

The accompanying notes to consolidated financial statements are an integral part of these statements.

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| | Year Ended May 31, | | |
|--|--------------------|---------------------|---------------------|
| | 2001 | 2000 | 1999 |
| OPERATING REVENUES: | | | |
| Motel, real estate and airport operations | \$ 2,222,400 | \$ 2,734,800 | \$ 2,888,000 |
| Contract drilling and construction | 2,238,600 | 3,584,900 | 3,584,900 |
| Mineral sales | 334,300 | -- | 8,000 |
| Mineral royalties | 108,500 | 132,600 | 15,000 |
| Management fees | 597,800 | 436,500 | 66,000 |
| | ----- | ----- | ----- |
| | 5,501,600 | 6,888,800 | 3,788,000 |
| OPERATING COSTS AND EXPENSES: | | | |
| Motel, real estate and airport operations | 3,236,200 | 3,387,300 | 3,438,000 |
| Contract drilling and construction operations | 1,750,500 | 4,179,200 | 1,179,200 |
| Mineral holding costs | 3,369,300 | 2,706,700 | 2,379,200 |
| General and administrative | 4,051,500 | 7,857,400 | 7,449,200 |
| Impairment of mineral properties | -- | -- | 13,220 |
| Abandonment of mining equipment | 123,800 | -- | -- |
| Provision for doubtful accounts | -- | 708,600 | 36,000 |
| | ----- | ----- | ----- |
| | 12,531,300 | 18,839,200 | 26,868,000 |
| | ----- | ----- | ----- |
| OPERATING LOSS | (7,029,700) | (11,950,400) | (23,079,000) |
| OTHER INCOME & EXPENSES | | | |
| Gain on sales of assets | 1,163,600 | 71,400 | 14,000 |
| Litigation settlements, net | 7,132,800 | -- | 6,070 |
| Interest income | 699,700 | 813,600 | 84,000 |
| Interest expense | (265,300) | (82,800) | (4,000) |
| | ----- | ----- | ----- |
| | 8,730,800 | 802,200 | 7,020,000 |
| | ----- | ----- | ----- |
| INCOME (LOSS) BEFORE MINORITY INTEREST AND EQUITY OF LOSS OF AFFILIATES | 1,701,100 | (11,148,200) | (16,058,000) |
| MINORITY INTEREST IN LOSS OF CONSOLIDATED SUBSIDIARIES | 220,100 | 509,300 | 4,460,000 |
| EQUITY IN LOSS OF AFFILIATES | -- | (2,900) | (5,000) |
| | ----- | ----- | ----- |

(Continued)

The accompanying notes to consolidated financial statements are an integral part of these statements.

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

| | Year Ended May 31, | | |
|--|--------------------|-----------------|-----------------|
| | 2001 | 2000 | 1999 |
| INCOME (LOSS) BEFORE INCOME TAXES | 1,921,200 | (10,641,800) | (11,641,800) |
| PROVISION FOR INCOME TAXES | -- | -- | -- |
| NET INCOME (LOSS) | 1,921,200 | (10,641,800) | (11,641,800) |
| PREFERRED STOCK DIVIDENDS | (150,000) | (20,800) | -- |
| NET INCOME (LOSS) AVAILABLE TO COMMON SHAREHOLDERS | \$ 1,771,200 | \$ (10,662,600) | \$ (11,641,800) |
| NET INCOME (LOSS) PER SHARE BASIC FROM CONTINUED OPERATIONS | 0.23 | (1.39) | -- |
| FROM DISCONTINUED OPERATIONS | -- | -- | -- |
| | 0.23 | (1.39) | -- |
| NET INCOME (LOSS) PER SHARE DILUTED FROM CONTINUED OPERATIONS | 0.21 | (1.39) | -- |
| FROM DISCONTINUED OPERATIONS | -- | -- | -- |
| | 0.21 | (1.39) | -- |
| BASIC WEIGHTED AVERAGE SHARES OUTSTANDING | 7,826,001 | 7,673,475 | 7,130,000 |
| DILUTED WEIGHTED AVERAGE SHARES OUTSTANDING | 8,487,680 | 7,673,475 | 7,130,000 |

The accompanying notes to consolidated financial statements are an integral part of these statements.

U.S. ENERGY CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

| | Common Stock | | Additional Paid-In Capital | Accumulated Deficit |
|---|--------------|-----------|----------------------------------|------------------------|
| | Shares | Amount | | |
| Balance May 31, 1998 | 7,523,492 | \$ 75,200 | \$ 28,526,200 | \$ (7,760,100) |
| Funding of ESOP | 89,600 | 900 | 357,500 | -- |
| Issuance of employee options below market value | -- | -- | 262,000 | -- |
| Issuance of common stock for services rendered | 131,136 | 1,300 | 386,400 | -- |
| Issuance of common stock for exercise of YSFC exchange | 677,167 | 6,800 | 2,591,500 | -- |
| Fair value of warrants and options issued for services rendered | -- | -- | 176,000 | -- |
| Fair value of warrants issued for exercise of YSFC exchange | -- | -- | 167,000 | -- |
| Issuance of common stock to acquire SGMC special warrants, net of offering costs | 89,059 | 1,000 | 278,900 | -- |
| Purchase of treasury stock | -- | -- | -- | -- |
| Forfeitable shares earned | 40,170 | 400 | 269,400 | -- |
| Net loss | -- | -- | -- | (11,648,500) |
| | ----- | ----- | ----- | ----- |
| Balance May 31, 1999 | 8,550,624 | \$ 85,600 | \$ 33,014,900 | \$ (19,408,600) |
| | ===== | ===== | ===== | ===== |

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| | Treasury Stock | | Unallocated ESOP Contribution | Total Shareholders' Equity |
|--|----------------|----------------|-------------------------------------|----------------------------------|
| | Shares | Amount | | |
| Balance May 31, 1998 | 865,943 | \$ (2,460,800) | \$ (927,000) | \$ 17,453,500 |
| Funding of ESOP | -- | -- | -- | 358,400 |
| Issuance of employee options below market value | -- | -- | -- | 262,000 |
| Issuance of common stock | | | | |

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| | | | | |
|------------------------------------|---------|----------------|--------------|---------------|
| for services rendered | -- | -- | -- | 387,700 |
| Issuance of common stock | | | | |
| for exercise of YSFC exchange | -- | -- | -- | 2,598,300 |
| Fair value of warrants and options | | | | |
| issued for services rendered | -- | -- | -- | 176,000 |
| Fair value of warrants issued for | | | | |
| exercise of YSFC exchange | -- | -- | -- | 167,000 |
| Issuance of common | | | | |
| stock to acquire SGMC | | | | |
| special warrants, net of | | | | |
| offering costs | -- | -- | -- | 279,900 |
| Purchase of treasury stock | 64,589 | (123,800) | -- | (123,800) |
| Forfeitable shares earned | -- | -- | -- | 269,800 |
| Net loss | -- | -- | -- | (11,648,500) |
| | ----- | ----- | ----- | ----- |
| Balance May 31, 1999 | 930,532 | \$ (2,584,600) | \$ (927,000) | \$ 10,180,300 |
| | ===== | ===== | ===== | ===== |

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U.S. ENERGY CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(CONTINUED)

| | Common Stock | | Additional | Accumulated |
|-----------------------------------|--------------|-----------|--------------------|-----------------|
| | Shares | Amount | Paid-In Capital | Deficit |
| | ----- | ----- | ----- | ----- |
| Balance May 31, 1999 | 8,550,624 | \$ 85,600 | \$ 33,014,900 | \$ (19,408,600) |
| Funding of ESOP | 123,802 | 1,200 | 370,200 | -- |
| Issuance of common stock | | | | |
| to outside directors | 6,020 | 100 | 21,000 | -- |
| Issuance of common stock | | | | |
| for purchase of subsidiary stock | 73,109 | 700 | 259,900 | -- |
| Forfeitable shares earned | 9,600 | 100 | 88,000 | -- |
| Treasury stock from consolidation | | | | |
| of subsidiaries Ruby Mining Co. | | | | |
| and Northwest Gold, Inc. | -- | -- | -- | -- |
| Unrealized gain on sale of | | | | |
| subsidiary stock | -- | -- | 1,053,700 | -- |
| Non-cash compensation | | | | |
| paid by subsidiary | -- | -- | 2,990,000 | -- |
| Writedown of unallocated | | | | |

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| | | | | |
|----------------------|-----------|-----------|---------------|-----------------|
| ESOP contribution | -- | -- | -- | -- |
| Net Loss | -- | -- | -- | (10,662,600) |
| | ----- | ----- | ----- | ----- |
| Balance May 31, 2000 | 8,763,155 | \$ 87,700 | \$ 37,797,700 | \$ (30,071,200) |
| | ===== | ===== | ===== | ===== |

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| | Treasury Stock | | Unallocated | Total |
|--|----------------|----------------|--------------|---------------|
| | Shares | Amount | ESOP | Shareholders' |
| | ----- | ----- | ----- | ----- |
| Balance May 31, 1999 | 930,532 | \$ (2,584,600) | \$ (927,000) | \$ 10,180,300 |
| Funding of ESOP | -- | -- | -- | 371,400 |
| Issuance of common stock to outside directors | -- | -- | -- | 21,100 |
| Issuance of common stock for purchase of subsidiary stock | -- | -- | -- | 260,600 |
| Forfeitable shares earned | -- | -- | -- | 88,100 |
| Treasury stock from consolidation of subsidiaries Ruby Mining Co. and Northwest Gold, Inc. | 14,193 | (55,300) | -- | (55,300) |
| Unrealized gain on sale of subsidiary stock | -- | -- | -- | 1,053,700 |
| Non-cash compensation paid by subsidiary | -- | -- | -- | 2,990,000 |
| Writedown of unallocated ESOP contribution | -- | -- | 436,500 | 436,500 |
| Net Loss | -- | -- | -- | (10,662,600) |
| | ----- | ----- | ----- | ----- |
| Balance May 31, 2000 | 944,725 | \$ (2,639,900) | \$ (490,500) | \$ 4,683,800 |
| | ===== | ===== | ===== | ===== |

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CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(CONTINUED)

| | Common Stock | | Additional Paid-In Capital | Accumulated Deficit |
|--|--------------|-----------|----------------------------------|------------------------|
| | Shares | Amount | | |
| Balance May 31, 2000 | 8,763,155 | \$ 87,700 | \$ 37,797,700 | \$ (30,071,200) |
| Funding of ESOP | 53,837 | 500 | 287,500 | -- |
| Issuance of common stock to outside directors | 8,532 | 100 | 19,100 | -- |
| Forfeitable shares earned | 29,820 | 300 | 193,900 | -- |
| Issuance of common stock for services rendered | 15,000 | 200 | 70,400 | -- |
| Treasury stock from payment on balance of note receivable | -- | -- | -- | -- |
| Sale of Ruby Mining | -- | -- | 25,800 | -- |
| Issuance of common stock for exercised options | 118,703 | 1,200 | 287,200 | -- |
| Net income | -- | -- | -- | 1,771,200 |
| Balance May 31, 2001 | 8,989,047 | \$ 90,000 | \$ 38,681,600 | \$ (28,300,000) |

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| | Treasury Stock | | Unallocated ESOP Contribution | Total Shareholders' Equity |
|--|----------------|----------------|-------------------------------------|----------------------------------|
| | Shares | Amount | | |
| Balance May 31, 2000 | 944,725 | \$ (2,639,900) | \$ (490,500) | \$ 4,683,800 |
| Funding of ESOP | -- | -- | -- | 288,000 |
| Issuance of common stock to outside directors | -- | -- | -- | 19,200 |
| Forfeitable shares earned | -- | -- | -- | 194,200 |
| Issuance of common stock for services rendered | -- | -- | -- | 70,600 |
| Treasury stock from payment on balance of note receivable | 5,000 | (20,600) | -- | (20,600) |
| Sale of Ruby Mining | -- | -- | -- | 25,800 |
| Issuance of common stock for exercised options | -- | -- | -- | 288,400 |
| Net income | -- | -- | -- | 1,771,200 |

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| | | | | |
|----------------------|---------|----------------|--------------|--------------|
| Balance May 31, 2001 | 949,725 | \$ (2,660,500) | \$ (490,500) | \$ 7,320,600 |
| | ===== | ===== | ===== | ===== |

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U.S. ENERGY CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Year Ended May 31, | | |
|---|--------------------|--------------------|------------------|
| | 2001 | 2000 | 1999 |
| | ----- | ----- | ----- |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Net income (loss) | \$ 1,771,200 | \$ (10,662,600) | \$ (11,648,500) |
| Adjustments to reconcile net income (loss) to net cash used in operating activities: | | | |
| Minority interest in loss of consolidated subsidiaries | (220,100) | (509,300) | (4,468,400) |
| Depreciation and amortization | 1,254,000 | 1,273,000 | 1,115,100 |
| Impairment of mineral interests | 123,800 | -- | 13,224,400 |
| Noncash services | 19,100 | 21,100 | 25,300 |
| Equity in loss from affiliates | -- | 2,900 | 59,100 |
| SMP settlement | -- | -- | 5,026,000 |
| Gain on sale of assets | (1,163,600) | (71,400) | (140,100) |
| Provision for doubtful accounts | -- | 708,600 | 465,000 |
| Non-cash compensation | 501,700 | 3,361,400 | 914,000 |
| Deferred income | (4,000,000) | -- | -- |
| Other | -- | -- | (36,300) |
| Net changes in assets and liabilities: | | | |
| Accounts and notes receivable | 1,241,000 | (536,500) | 946,500 |
| Other assets | (112,700) | 92,200 | 147,700 |
| Accounts payable and accrued expenses | (887,300) | (217,200) | (1,318,800) |
| Reclamation and other | -- | 45,900 | 82,100 |
| | ----- | ----- | ----- |
| NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES | (1,472,900) | (6,491,900) | 4,393,100 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Exploration of coalbed methane gas properties | \$ (1,187,800) | \$ (4,727,200) | \$ -- |
| Proceeds from sale of property and equipment | 2,608,000 | 78,300 | 470,300 |
| Increase in restricted investments | (417,700) | (200,600) | (271,300) |
| Purchase of property and equipment | (311,400) | (2,240,000) | (1,076,000) |
| Investments in affiliates | 292,400 | (12,500) | 54,200 |
| | ----- | ----- | ----- |
| NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES | 983,500 | (7,102,000) | (822,800) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | |
| Proceeds from issuance of common stock | \$ 288,400 | \$ -- | \$ -- |
| Proceeds from issuance of preferred stock | -- | 1,840,000 | -- |

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| | | | |
|--|-----------|-------------|-----------|
| Proceeds from sale of stock by subsidiary | -- | 2,160,000 | -- |
| Proceeds from long-term debt | 619,100 | 886,400 | 48,000 |
| Net proceeds from lines of credit | 200,000 | 650,000 | -- |
| Purchase of treasury stock | (20,600) | -- | (123,800) |
| Repayments of long-term debt | (828,400) | (1,246,300) | (395,200) |
| Cash acquired in purchase of subsidiary | -- | 47,200 | 1,423,200 |
| | ----- | ----- | ----- |
| NET CASH PROVIDED BY FINANCING ACTIVITIES | 258,500 | 4,337,300 | 952,200 |
| | ----- | ----- | ----- |

The accompanying notes to consolidated financial statements are an integral part of these statements.

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

| | Year Ended May 31, | | |
|---|--------------------|-------------|---------------|
| | 2001 | 2000 | 1999 |
| | ----- | ----- | ----- |
| NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS | (230,900) | (9,256,600) | 4,522,500 |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 916,400 | 10,173,000 | 5,650,500 |
| | ----- | ----- | ----- |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | \$ 685,500 | \$ 916,400 | \$ 10,173,000 |
| | ===== | ===== | ===== |
| SUPPLEMENTAL DISCLOSURE | | | |
| Income tax paid | \$ -- | \$ -- | \$ -- |
| | ===== | ===== | ===== |
| Interest paid | \$ 265,300 | \$ 35,800 | \$ 44,500 |
| | ===== | ===== | ===== |
| NON-CASH INVESTING AND FINANCING ACTIVITIES: | | | |
| Satisfaction of receivable - affiliate with stock in affiliate | \$ 3,000,000 | \$ 196,700 | \$ 275,000 |
| | ===== | ===== | ===== |
| Acquisition of assets through issuance of debt | \$ 1,631,700 | \$ 506,000 | \$ 756,000 |
| | ===== | ===== | ===== |
| Sale of assets through accounts receivable | \$ 1,164,500 | \$ -- | \$ -- |

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| | | | |
|--|------------|------------|------------|
| Issuance of stock to purchase subsidiary | \$ -- | \$ -- | \$ 2,878,2 |
| Issuance of stock as deferred compensation | \$ 358,400 | \$ 201,000 | \$ 267,9 |
| Issuance of stock for services | \$ 70,500 | \$ -- | \$ 68,8 |
| Issuance of stock for retired employees | \$ 194,400 | \$ 88,100 | \$ 269,8 |
| Valuation of stock options and warrants | \$ -- | \$ -- | \$ 343,0 |

The accompanying notes to consolidated financial statements are an integral part of these statements.

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U.S. ENERGY CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2001

A. BUSINESS ORGANIZATION AND OPERATIONS:

U.S. Energy Corp. and subsidiaries (the "Company" or "USE") was incorporated in the State of Wyoming on January 26, 1966. The Company engages in the acquisition, exploration, holding, sale and/or development of mineral and coalbed methane gas properties, the production of petroleum properties and marketing of minerals and methane gas. Principal mineral interests are in uranium, gold, molybdenum and coalbed methane. None of the Company's mineral properties are currently in production. The Company holds various real and personal properties used in commercial activities. The Company also performs contract drilling and construction work on third party properties. Most of these activities are conducted through the joint venture discussed below and in Note D.

The Company was engaged in the maintenance of two uranium properties, one a joint venture with Kennecott Uranium Company ("Kennecott") known as the Green Mountain Mining Venture ("GMMV"), and the second known as Sheep Mountain Partners ("SMP"). Both of these ventures have been involved in significant litigation (see Note K). All issues and disputes in the SMP litigation have been resolved with the exception of purchase rights and the profits therefrom on certain CIS related uranium contracts. The resolution of the other issues resulted in the payment of cash to the Company and the receipt of the SMP mineral properties and one uranium delivery contract. The remaining issues have been referred to a special master for resolution by the U.S. District Court of Colorado. The litigation with Kennecott has been settled. Sutter Gold Mining Company ("SGMC"), a Wyoming corporation owned 66.3% by the Company at May 31, 2001, manages the Company's interest in gold properties. The Company also owns 100% of the outstanding stock of Plateau Resources Limited ("Plateau"), which

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owns a nonoperating uranium mill and support facilities in southeastern Utah. Currently, the mill is nonoperating but has been granted a license to operate subject to certain conditions. Rocky Mountain Gas, Inc. ("RMG") was formed in fiscal 2000 to consolidate all methane gas operations of the Company. The Company owns and controls 84% of RMG as of May 31, 2001.

The Company has generated significant net losses prior to fiscal 2001 resulting in an accumulated deficit of approximately \$28,300,000 at May 31, 2001. The Company has a working capital balance of approximately \$933,300 at May 31, 2001. The Company's cash balance has decreased from \$916,400 at the prior year end to \$685,500 at May 31, 2001. At year end, the Company did not have the working capital necessary to continue to fund anticipated development activities in its coalbed methane properties. The Company has therefore entered into joint ventures to develop its properties. In order to reduce its overhead costs, the Company reduced its staff during 2001. In addition, the Company continues to believe that it will ultimately receive more cash from the final settlement of the SMP litigation. Taken together, the Company believes it will be able to meet its obligations during the upcoming year.

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U.S. ENERGY CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MAY 31, 2001 (CONTINUED)

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements of USE and subsidiaries include the accounts of the Company, the accounts of its majority-owned subsidiaries Plateau (100%), Energx, Ltd ("Energx") (90%), Four Nines Gold, Inc. ("FNG") (50.9%), SGMC (66.3%), Crested Corp. ("Crested") (70.5%), Yellowstone Fuels Corp. ("YSFC") (35.9%) Rocky Mountain Gas ("RMG") (82%), Northwest Gold, Inc. ("NWG") (96%) and the USECC Joint Venture ("USECC"), a consolidated joint venture which is equally owned by U.S. Energy Corp. and Crested, through which the bulk of their operations are conducted.

Prior to fiscal 2001, Ruby Mining Company ("Ruby") which was 91% owned by the Company, was also consolidated. During 2001, Ruby was sold to a third party and therefore is no longer consolidated.

With the exception of YSFC, investments in joint ventures and all 20% to 50% owned companies are accounted for using the equity method (see Note E). YSFC was an equity investee through February 1999, at which time the Company purchased the majority of the shares of common stock of YSFC owned by outside shareholders by issuing 677,167 shares of Company's common stock. As a result of the common directors and control of YSFC by USE and its employees, YSFC was consolidated as of March 1, 1999. SGMC was an equity investee through March 1998 when the Company purchased special warrant units from certain investors and increased its ownership to 59%, requiring consolidation subsequent to April 1, 1998 (see Note F). Investments of less than 20% are accounted for by the cost method. All material intercompany profits, transactions and balances have been eliminated.

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CASH EQUIVALENTS

The Company considers all highly liquid investments with original maturities of three months or less to be restricted cash equivalents.

RESTRICTED INVESTMENTS

Based on the provisions of Statement of Financial Accounting Standards No. 115 ("SFAS 115"), the Company accounts for its restricted investment in certain securities as held-to-maturity. Held-to-maturity securities are measured at amortized cost and are carried at the lower of aggregate cost or fair market value.

INVENTORIES

Inventories consist primarily of retail inventory of aviation and automobile fuel and associated aircraft parts for motel, real estate and airport operations, mining supplies and gold stockpiles. Retail inventories are stated at lower of cost or market using the average cost method. Mine supplies and gold stockpile inventories are stated at the lower of cost or market.

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U.S. ENERGY CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MAY 31, 2001 (CONTINUED)

PROPERTIES AND EQUIPMENT

Land, buildings, improvements, machinery and equipment are carried at cost. Depreciation of buildings, improvements, machinery and equipment is provided principally by the straight-line method over estimated useful lives ranging from 3 to 45 years. Following is a breakdown of the lives over which assets are depreciated.

| | |
|--------------------------------|---------------|
| Office Equipment | 3 to 5 years |
| Field Tools and Hand Equipment | 5 to 7 years |
| Vehicles and Trucks | 3 to 7 years |
| Heavy Equipment | 7 to 10 years |
| Service Buildings | 20 years |
| Corporate Headquarters | 45 years |

The Company capitalizes all costs incidental to the acquisition and exploration of mineral properties as incurred. Costs are charged to operations if the Company determines that a property is not economical. Costs and expenses related to general corporate overhead are expensed as incurred.

The Company has acquired substantial mining properties and associated facilities at minimal cash cost, primarily through the assumption of reclamation and environmental liabilities. Certain of these properties are owned by various ventures in which the Company is either a partner or venturer. (See Note K.)

OIL AND GAS PROPERTIES

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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 added to the capitalized costs to be amortized.

In addition, the capitalized costs are subject to a "ceiling test," which basically limits such costs to the aggregate of the "estimated present value," discounted at a 10-percent interest rate of future net revenues from proved reserves, based on current economic and operating conditions, plus the lower of cost or fair market value of unproved properties.

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U.S. ENERGY CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MAY 31, 2001

(CONTINUED)

As of May 31, 2001 the Company had not begun testing the exploratory wells it had drilled (ie. had not begun the dewatering process). Until sufficient wells are drilled and completed on a prospect, and sufficiently dewatered, the amount of reserves (if any) cannot be determined. This process can take up to 24 months from when the first few wells are drilled. The Company therefore cannot determine at May 31, 2001 if an impairment of acquisition and impairment costs has occurred. In the event that the drilling and dewatering efforts do not produce economic reserves, the acquisition, exploration and development costs associated with the property will be written off.

Sales of proved and unproved properties are accounted for as adjustments of capitalized costs with no gain or loss recognized, unless such adjustments would significantly alter the relationship between capitalized costs and proved reserves of oil and gas, in which case the gain or loss is recognized in income. Abandonments of properties are accounted for as adjustments of capitalized costs with no loss recognized.

LONG-LIVED ASSETS

The Company evaluates its long-lived assets (other than oil and gas properties which are discussed above) for impairment when events or changes in circumstances indicate that the related carrying amount may not be recoverable. If the sum of estimated future cash flows on an undiscounted basis is less than the carrying amount of the related asset, an asset impairment is considered to exist. The related impairment loss is measured by comparing estimated future cash flows on a discounted basis to the carrying amount of the asset. Changes in

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significant assumptions underlying future cash flow estimates may have a material effect on the Company's financial position and results of operations. An uneconomic commodity market price, if sustained for an extended period of time, or an inability to obtain financing necessary to develop mineral interests, may result in asset impairment. During fiscal 2001, the Company recorded an impairment on its mineral assets of \$123,800 in YSFC. During fiscal 1999, the Company recorded an impairment of \$10,718,300 on its mineral assets in SGMC and \$2,506,100 on its mineral assets in YSFC. As of May 31, 2001, management believes no further impairment is necessary. See Note F for further discussion.

FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amount of cash equivalents, receivables, other current assets, accounts payable and accrued expenses approximates fair value because of the short-term nature of those instruments. The recorded amounts for short-term and long-term debt, approximate fair value due to the variable nature of the interest rates on the debt.

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U.S. ENERGY CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MAY 31, 2001

(CONTINUED)

REVENUE RECOGNITION

Revenues from motel, real estate and airport operations are for the rental of motel rooms, boat storage facilities and mobile home lots at the Company's operations in southern Utah as well as the rental of office space in office buildings in Riverton, Wyoming. Airport operations consist of the sale of aviation fuel, repair and maintenance of aircraft and rental of hanger space. All these revenues are reported on a gross revenue basis and are recorded at the time the service is provided.

Revenues from mineral sales consist of the sale of uranium to a delivery contract and the sale of that contract to a third party supplier. The sale of uranium is reported on a net basis. The Company has not produced any uranium from its properties during the period covered by the enclosed financial statements and has purchased all uranium delivered under its supply contracts from the open market as all the Company's uranium operations are shut down.

Mineral royalties which are non-refundable are recognized as revenue when received (see Note F).

Management fees are recorded as a percentage of actual costs for services provided for subsidiaries and partnerships for which the Company provides management services. The Company is also paid a management fee for overseeing oil production on the Fort Peck Reservation in Montana. Management fees are recorded when the service is provided.

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Revenues from motel, real estate and airport operations, which represent primarily real estate activity and an airport fixed base operation, are recognized as goods and services are delivered. Revenues from construction/drilling contracts are recognized as work is completed. Oil and gas revenue is recognized at the time of product delivery.

INCOME TAXES

The Company accounts for income taxes under the provisions of Statement of Financial Accounting Standards No. 109 ("SFAS 109"), "Accounting for Income Taxes". This statement requires recognition of deferred income tax assets and liabilities for the expected future income tax consequences, based on enacted tax laws, of temporary differences between the financial reporting and tax bases of assets, liabilities and carryforwards.

SFAS 109 requires recognition of deferred tax assets for the expected future effects of all deductible temporary differences, loss carryforwards and tax credit carryforwards. Deferred tax assets are reduced, if

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U.S. ENERGY CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MAY 31, 2001

(CONTINUED)

deemed necessary, by a valuation allowance for any tax benefits which, based on current circumstances, are not expected to be realized.

NET (LOSS) INCOME PER SHARE

The Company reports net (loss) income per share pursuant to Statement of Financial Accounting Standards No. 128 ("SFAS 128"). SFAS 128 specifies the computation, presentation and disclosure requirements for earnings per share. Basic earnings per share is computed based on the weighted average number of common shares outstanding. Diluted earnings per share is computed based on the weighted average number of common shares outstanding adjusted for the incremental shares attributed to outstanding options to purchase common stock, if dilutive.

COMPREHENSIVE INCOME

There are no components of comprehensive income which have been excluded from net income and, therefore, no separate statement of comprehensive income has been presented.

RECENT ACCOUNTING PRONOUNCEMENTS

SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," establishes fair value accounting and reporting standards for derivative instruments and hedging activities. The Company adopted SFAS No. 133 in the first quarter of fiscal 2001 and such adoption had no significant effect on the Company's financial statements.

The Company evaluated the effect of SFAS 140 on its financial statements

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and determined that the recently issued standard would not materially impact either the preparation of or the Company's financial position or results of operations. Management of the Company has reviewed all other recently issued standards and determined that they will not have a material affect on its financial position or results of operations.

USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

C. RELATED-PARTY TRANSACTIONS:

The Company provides management and administrative services for affiliates under the terms of various management agreements. Revenues from services by the Company to unconsolidated affiliates were

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U.S. ENERGY CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MAY 31, 2001

(CONTINUED)

\$132,500, \$39,900 and \$584,400 in fiscal 2001, 2000, and 1999, respectively. The Company has \$74,200 of receivables from unconsolidated subsidiaries as of May 31, 2001.

As of May 31, 2001, the Company had notes receivable due from certain directors and employees of the Company totaling \$180,300 due December 31, 2001. This indebtedness is secured by 161,500 shares of the Company's common stock. During fiscal 2001, this debt was reduced by \$114,900.

D. USECC JOINT VENTURE:

The Company operates the Glen L. Larsen office complex; an aircraft hangar with a fixed base operation, office space and certain aircraft; holds interests in various mineral operations; conducts oil and gas operations; and transacts all operating and payroll expenses through a joint venture with Crested, the USECC joint venture.

E. INVESTMENTS IN AND ADVANCES TO AFFILIATES:

The Company's restricted investments secure various decommissioning, reclamation and holding costs. Investments are comprised of debt securities issued by the U.S. Treasury that mature at varying times from three months to one year from the original purchase date. As of May 31, 2001 and 2000, the cost of debt securities was a reasonable approximation of fair market value. These investments are classified as held-to-maturity under SFAS 115 and are measured at amortized cost.

The Company's investment in and advances to affiliates are as follows:

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| | Consolidated Ownership | Carrying Value at May 31, | |
|----------------------|---------------------------|---------------------------|----------|
| | | 2001 | 2000 |
| Powder River Gas LLC | -- | \$ 16,200 | \$ 9,600 |

Equity loss from investments accounted for by the equity method are as follows:

| | Year Ended May 31, | | |
|-----------------------|--------------------|--------------|--------------|
| | 2001 | 2000 | 1999 |
| Ruby Mining Company** | \$ -- | \$ (2,900)** | \$ (3,100) |
| YSFC*** | -- | -- | (56,000) *** |
| | \$ -- | \$ (2,900) | \$ (59,100) |

** Consolidated beginning December 1, 1999. This represents the equity loss through November 30, 1999. Ruby was sold during fiscal 2001 and is no longer consolidated.

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U.S. ENERGY CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2001
(CONTINUED)

*** Consolidated beginning March 1, 1999. This represents the equity loss through February 28, 1999 at which time the Company acquired additional shares of YSFC and thereby obtained control.

Condensed combined balance sheets and statements of operations of the Company's equity investees for fiscal 2000 include Ruby Mining Company.

See Note F for a discussion of the reduction in the carrying value of such investee assets.

F. MINERAL CLAIMS TRANSACTIONS AND MINING PROPERTIES:

GMMV

During fiscal 1990, the Company entered into an agreement with Kennecott, a wholly-owned, indirect subsidiary of The RTZ Corporation plc, for Kennecott to acquire a 50% interest in certain uranium mineral properties in Wyoming known as

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the Green Mountain Properties. During the life of the venture, the parties entered into various amendments to the GMMV agreement.

As a result of sustained depressed uranium prices, the GMMV properties were maintained on a standby basis. During fiscal 2000, certain disputes arose in the GMMV venture and Kennecott sued the Company. On September 11, 2000, the parties settled all disputes by Kennecott paying the Company \$3.25 million and Kennecott assuming all reclamation liabilities of the GMMV Properties.

SMP

During fiscal 1989, the Company, through USECC, entered into an agreement to sell a 50% interest in their Sheep Mountain properties to Nukem's subsidiary CRIC. USECC and CRIC immediately contributed their 50% interests in the properties to a newly-formed partnership, Sheep Mountain Partners ("SMP"). SMP was established to further explore uranium mineralization on the claims on Sheep Mountain, acquire uranium supply contracts and market uranium. Certain disputes arose among USECC, CRIC and its parent Nukem, Inc. over the operation of SMP. These disputes have been in litigation/arbitration for the past ten years. See Note K for a description of the investment and a discussion of the related litigation/arbitration.

Due to the litigation and arbitration proceedings involving SMP for the past ten years, the Company has expensed all of its costs related to SMP and has had no carrying value of its investment in SMP for either 2001 or 2000 as proceeds from litigation and arbitration proceedings were accounted for under the cost recovery method of accounting as discussed in Note K. The Company's direct loss generated from its investment in SMP, which represents mine standby costs incurred directly by the Company, was \$399,300, \$711,300 and \$704,10 for the years ended May 31, 2001, 2000 and 1999, respectively.

As part of a partial settlement agreement dated June 1, 1998, the Company was awarded the return of its Sheep Mountain uranium mines and certain other properties. Accordingly, all mine standby costs and other holding costs were expensed by the Company during fiscal 2001, 2000 and 1999.

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U.S. ENERGY CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MAY 31, 2001 (CONTINUED)

PHELPS DODGE

During prior years, the Company conveyed interests in mining claims to AMAX Inc. ("AMAX") in exchange for cash, royalties, and other consideration. There are no remaining values on the balance sheets of the Company at May 31, 2001, 2000 or 1999, relating to these claims. AMAX merged with Cyprus Minerals ("Cyprus Amax") which was purchased by Phelps Dodge Mining Company ("Phelps Dodge") in December of 1999. The properties have not been placed into production as of May 31, 2001.

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AMAX and later Cyprus Amax, paid the Company an annual advance in royalty of 50,000 pounds of molybdenum (or its cash equivalent). During fiscal 2000, Phelps Dodge assumed this obligation and made payments to the Company during fiscal 2001. Phelps Dodge is entitled to a partial credit against future royalties for any advance royalty payments made, but such royalties are not refundable if the properties are not placed into production. The Company recognized \$108,500, \$132,600 and \$150,100 of revenue from the advance royalty payments in fiscal 2001, 2000 and 1999, respectively. Phelps Dodge has not made the payment of the advance royalty during the first quarter of 2002. The Company considers this a breach of Phelps Dodge's contractual obligations.

Phelps Dodge may elect to return the properties to the Company, which would cancel future obligations under the advance royalty obligation. If Phelps Dodge formally decides to place the properties into production, it is obligated to pay \$2,000,000 to the Company. Also, per the contract with AMAX, the Company is to receive 15% of the first \$25,000,000, or \$3,750,000, if the molybdenum properties are sold, which the Company believes has occurred.

The Company has recently entered into discussions with Phelps Dodge concerning the purchase of the properties from Cyprus Amax.

SUTTER GOLD MINE COMPANY

SGMC was established in 1990 to conduct operations on mining leases and to produce gold from the Lincoln properties in California. The SGMC Lincoln Project property is shut down . SGMC has not generated any significant revenue and has no assurance of future revenue. All acquisition and mine exploration costs since inception were initially capitalized. Due to the decline in the spot price for gold and the lack of adequate financing, SGMC has shut the SGMC operation down SGMC requires capital contributions from affiliates or other sources to maintain its current activities.

Primarily as a result of the sustained decline in gold prices and the uncertainty of when prices might recover, the Company

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U.S. ENERGY CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MAY 31, 2001

(CONTINUED)

evaluated the carrying value of its SGMC properties for impairment, and in fiscal 1999 and 1998, the Company recorded an impairment in the amount of \$10,718,300 and \$1,500,000 respectively .

This impairment, which was taken as required under the provisions of SFAS # 121, resulted in a write-off of nearly 85% of the cost of these assets to values that were estimated to be fair market values at that time based on the salvage values of equipment and the local tax assessor's assessed values of the land, buildings and improvements.

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Since the date of the last impairment in 1999, the Company has annually determined whether or not events or changes in circumstances had occurred suggesting that additional impairment of the assets of Sutter under SFAS # 121 was necessary. We did not deem it necessary to further impair the assets in 2000 or 2001 based on the assessed valuations of the property. An offer to purchase a portion of the land in Sutter during 2002 and current assessed valuations of the property and improvements suggest that the Sutter property is still valued at or below fair market value.

The Company will continue to evaluate the carrying value of its long-lived assets and long-lived assets to be disposed of under the provisions of SFAS # 121 and will obtain third-party appraisals of the properties during fiscal 2003 as additional support for the carrying values of the property.

In connection with a private offering, on March 21, 1997, the Company and Crested accepted a Contingent Stock Purchase Warrant which provides the Company and Crested the right to acquire, for no additional consideration, common shares of SGMC's \$.001 par value common stock having an aggregate value of \$10,000,000 (US). The Stock Purchase Warrant has a term of ten years extending to March 21, 2007, and is exercisable partially or in total, semi-annually beginning on June 30, 1997. However, the Stock Purchase Warrant is only exercisable to the extent proven and probable ore reserves, as defined in the Stock Purchase Warrant, in excess of 300,000 ounces are added to SGMC's reserves. In addition, SGMC has the right to satisfy the exercise of all or any portion of the Stock Purchase Warrant with the net cash flows, as defined, at \$25.00 (US) for each new ounce of proven and probable ore in excess of 300,000 ounces up to a maximum of 700,000 ounces. Accordingly, the Company has allocated the carrying value of SGMC shares exchanged for the Contingent Stock Purchase Warrant to its investment in such contingent warrants. The Stock Purchase Warrant benefits the Company and Crested on a basis of 88.9% and 11.1%, respectively.

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U.S. ENERGY CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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During 1999, the Company issued 89,059 shares of common stock to acquire an additional 207,500 SGMC Special Warrants. This purchase increased the Company's ownership of SGMC to 63%. During fiscal 2000, the Company issued an additional 15,357 shares of its common stock to acquire 5,500 additional SGMC Special Warrants. This purchase increased the Company's ownership of SGMC to 66%.

Additional financing will be required in order to develop SGMC.

YELLOW STONE FUELS CORP.

In fiscal 1998, the Company became contractually obligated to exchange its common stock for common stock of YSFC, plus interest, because certain conditions were not met (See Note J). As a result of depressed market prices for uranium, YSFC was not successful in the public offering of its common stock. As a result, the terms of the exchange agreement became effective between the Company and YSFC shareholders. The Company therefore issued 677,167 shares of its common

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stock. The exchange offer for YSFC remained effective until September 13, 1999.

Due to continued low uranium market prices and the inability to raise financing to place the YSFC properties into production, the Company recorded an impairment of \$123,800 in fiscal 2001 and \$2,506,100 in 1999 related to YSFC's mineral assets, which is classified as impairment of mineral assets in the accompanying Consolidated Statements of Operations. The impairment was specifically related to the YSFC mining equipment in fiscal 2001.

PLATEAU RESOURCES LIMITED

During fiscal 1994, the Company entered into an agreement with Consumers Power Company to acquire all the issued and outstanding common stock of Plateau, a Utah corporation. Plateau owns a uranium processing mill and support facilities and certain other real estate assets through its wholly-owned subsidiary Canyon Homesteads, Inc. in southeastern Utah. The Company paid nominal cash consideration for the Plateau stock and agreed to assume all environmental liabilities and reclamation bonding obligations. At May 31, 2001, Plateau had a cash security in the amount of \$9,664,000 to cover reclamation of the properties (see Note K).

The Company is currently evaluating the best utilization of Plateau's properties. Evaluations are ongoing to determine when, or if, the mine and mill properties should be placed into production. The primary factor in these evaluations relates to the current depressed uranium market. Revenues are being generated from the townsite assets which include a motel, C-store, lounge, restaurant, boat storage facility and housing.

The convenience store, lounge and restaurant, and boat storage facility are leased to third party companies. The Company receives rent on these facilities and a percentage of the revenues of each operation. The Company is also considering the possibility of selling the mill facility.

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U.S. ENERGY CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MAY 31, 2001 (CONTINUED)

RUBY MINING COMPANY

During fiscal 2001, the Company sold its controlling interest in Ruby Mining Company to Admiralty Company. The Company retained 900,000 shares of Ruby Mining common stock; received \$100,000 upon closing, and a promissory note in the amount of \$225,000. Although the promissory note is currently in default, management believes that Admiralty will pay the balance due during the second quarter of 2002.

ROCKY MOUNTAIN GAS, INC.

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During fiscal 2000, the Company organized RMG to enter into the coalbed methane gas business. RMG is engaged in the acquisition of coalbed methane gas leases and the exploration, development and production of methane gas from those properties. The Company owns and controls 84% of RMG. RMG sold 55,500 shares and 1,206,333 shares of its common stock in a private placement during fiscal 2001 and 2000 respectively, for total proceeds of approximately \$3,721,900.

RMG entered into an agreement with Quantum Energy, L.L.C. (Quantum has since changed its name to ("Quaneco")) on January 3, 2000 to purchase a 50% working interest and 40% net revenue interest in approximately 185,000 acres of unproven leasehold interests in the Powder River Basin of southeastern Montana. The terms of the Quantum agreement were payments of \$3,200,000 on closing, \$1,000,000 on or before May 1, 2000 and \$1,300,000 on or before December 31, 2000. RMG also had a \$2,500,000 work commitment to drill approximately 25 wells on the Quantum properties by November 30, 2000.

During fiscal 2001, RMG and Quaneco entered into an Option and Farmin Agreement with Suncor (Natural Gas) America, Inc. ("SENGAI") on 112,000 acres in southeast Montana. SENGAI paid \$1,705,000 for the right to exercise the option, of which \$1,278,800 was due to RMG. These funds were applied to the final payment due under to Quaneco agreement. All amounts due to Quaneco had been paid as of May 31, 2001.

SENGAI also committed to assume \$2,000,000 of the remaining \$2,250,000 drilling commitment that RMG had under its drilling commitment to Quaneco. If SENGAI exercises its option on the acreage an additional \$3,923,700 will be due to the Company and Quantum, of which \$2,942,800 will be due to the Company. Upon Exercise of the option, SENGAI is also committed to fund a disproportional \$841,400 on the second drilling program on the properties.

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U.S. ENERGY CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MAY 31, 2001 (CONTINUED)

If SENGAI exercises its option, RMG will own a 12.5% working interest and a 10% revenue interest in the 112,000 acres (subject to the CCBM agreement). Should SENGAI not elect to exercise its option, RMG will revert to a 50% working interest, 40% revenue interest in the acreage.

RMG also acquired a 100% working interest (82% revenue interest) in 63,000 net mineral acres in southwest Wyoming. These coalbed methane gas leases are in the greater Green River Basin. RMG purchased these leases for cash and drilling commitments.

On July 10, 2001, RMG closed a Purchase and Sale Agreement with CCBM, Inc. ("CCBM"), a wholly-owned subsidiary of Carrizo Oil & Gas, Inc. of Houston, Texas. CCBM purchased an undivided 50% interest in all of RMG's existing coalbed properties. CCBM signed a \$7,500,000 Promissory Note payable in principal amounts of \$125,000 per month plus interest at annual rate of 8% over 41 months (starting July 31, 2001) with a balloon payment due on the forty-second month.

The 50% undivided interest is pledged back to RMG to secure the purchase

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price, and will be released 25% when 33.3% of the principal amount of the purchase price is paid, another 25% when the total principal payments reach 66% of the principal amount of the purchase price and the balance when the total principal amount is paid.

CCBM has also agreed to fund \$5,000,000 for an initial drilling program. If CCBM fails to expend \$5,000,000 in the drilling program or \$2,500,000 for RMG's benefit, CCBM will be obligated to pay any remaining unspent portions of the \$2,500,000 directly to RMG. If CCBM defaults on its purchase obligation CCBM will still earn a 50% working interest in each well location (80 acres) and production therefrom. CCBM's ownership will be earned on these wells regardless of the status of the payments on the promissory note.

CCBM will be entitled to a credit (applied as a prepayments of the purchase price for the production of the undivided 50% interest in RMG's acreage), equal to 20% of RMG's net revenue interest from wells drilled with the \$5,000,000 until CCBM equals \$1,250,000 from production proceeds.

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U.S. ENERGY CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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(CONTINUED)

OIL AND GAS PROPERTIES AND EQUIPMENT INCLUDED THE FOLLOWING:

| | May 31, | | |
|---|--------------|--------------|--------------|
| | 2001 | 2000 | 1999 |
| | ----- | ----- | ----- |
| Oil and gas properties: | | | |
| Subject to amortization | \$ 1,773,600 | \$ 1,773,600 | \$ 1,773,600 |
| Not subject to amortization: | | | |
| Acquired in fiscal 2001 | 1,154,500 | -- | -- |
| Acquired in fiscal 2000 | 4,727,200 | 4,727,200 | -- |
| Acquired in fiscal 1999 | -- | -- | -- |
| Acquired prior to fiscal 1999 | -- | -- | -- |
| | ----- | ----- | ----- |
| | 7,655,300 | 6,500,800 | 1,773,600 |
| Accumulated depreciation, depletion and amortization | (1,773,600) | (1,773,600) | (1,773,600) |
| | ----- | ----- | ----- |
| Net oil and gas properties | \$ 5,881,700 | \$ 4,727,200 | \$ -- |
| | ===== | ===== | ===== |

The Company began drilling of its coalbed methane properties during fiscal 2001. At such time as production begins on these properties the cost associated

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with the development of such production will be added to the amortization base. Production is projected to begin in the second half of fiscal 2002 or the beginning of fiscal 2003.

G. DEBT:

LINES OF CREDIT

The Company had a \$1,000,000 line of credit from a commercial bank. The line of credit had a variable interest rate (8.5% as of May 31, 2001). The weighted average interest rate for 2001 was 9.8%. As of May 31, 2001, \$850,000 was outstanding on this line of credit. The line of credit is secured by certain real property and a share of the net proceeds of fees from production from certain oil wells.

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U.S. ENERGY CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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(CONTINUED)

LONG-TERM DEBT

The components of long-term debt as of May 31, 2001 and 2000 are as follows:

| | May 31, | |
|--|--------------|------------|
| | 2001 | 2000 |
| | ----- | ----- |
| USECB installment notes - secured by equipment; interest at 7.9% to 11.4%, matures in 2002-2015 | \$ 1,670,200 | \$ 315,500 |
| SGMC installment notes - secured by certain mining properties, interest at 7.5% to 8.0%, maturity from 2001 - 2007 | 624,300 | 740,800 |
| RMG installment note - secured by coalbed methane leases, interest at 8%; repaid in fiscal 2001 | -- | 106,200 |
| FNG installment note - secured by FNG equipment, interest at 8.9%; repaid in fiscal 2001 | -- | 21,700 |
| | ----- | ----- |
| | 2,294,500 | 1,184,200 |
| Less current portion | (142,400) | (284,100) |
| | ----- | ----- |
| | \$ 2,152,100 | \$ 900,100 |
| | ===== | ===== |

Principal requirements on long-term debt are \$142,400, \$123,800; \$126,500;

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\$105,000; \$94,600; \$1,702,200 for the years 2002 through 2006 and thereafter, respectively.

H. INCOME TAXES:

The components of deferred taxes as of May 31, 2001 and 2000 are as follows:

| | May 31, | |
|-----------------------------------|----------------------------|----------------------------|
| | 2001 | 2000 |
| Deferred tax assets: | | |
| Deferred compensation | \$ 279,000 | \$ 213,400 |
| Net operating loss carryforwards | 8,180,000 | 9,583,200 |
| Tax Credits | 15,000 | 17,900 |
| Non-deductible reserves and other | 840,000 | 1,146,000 |
| Tax basis in excess of book basis | 2,850,400 | 3,876,500 |
| Total deferred tax assets | 12,164,400 | 14,837,000 |
| Deferred tax liabilities: | | |
| Development and exploration costs | 2,157,200 | 2,014,300 |
| Total deferred tax liabilities | 2,157,200 | 2,014,300 |
| Valuation allowance | 10,007,200 (11,152,000) | 12,822,700 (13,967,500) |
| Net deferred tax liability | \$ (1,144,800) | \$ (1,144,800) |

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U.S. ENERGY CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MAY 31, 2001 (CONTINUED)

The Company has established a valuation allowance of \$11,152,000 and \$13,967,500 against deferred tax assets due to the losses incurred by the Company in past fiscal years. The Company's ability to generate future taxable income to utilize the NOL carryforwards is uncertain.

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

Year Ended May 31,

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| | 2001 | 2000 | 1999 |
|--|-------------|----------------|----------------|
| Expected federal income tax | \$ 602,200 | \$ (3,618,200) | \$ (3,960,500) |
| Net operating losses not previously benefitted and other | 2,213,300 | (10,600) | 422,100 |
| Valuation allowance | (2,815,500) | 3,628,800 | 3,538,400 |
| Income tax provision | \$ -- | \$ -- | \$ -- |

There were no taxes currently payable as of May 31, 2001, 2000 or 1999 related to continuing operations.

At May 31, 2001, the Company and its subsidiaries had available, for federal income tax purposes, net operating loss carryforwards of approximately \$25,000,000 which will expire from 2002 to 2021 and investment tax credit carryforwards of \$15,000 which, if not used, will expire from 2001 to 2002. The Internal Revenue Code contains provisions which limit the NOL carryforwards available which can be used in a given year when significant changes in company ownership interests occur. In addition, the NOL and credit amounts are subject to examination by the tax authorities.

The Internal Revenue Service has audited the Company's and subsidiaries tax returns through the year ended May 31, 1996. The Company's income tax liabilities are settled through fiscal 1996.

I. SEGMENTS AND MAJOR CUSTOMERS:

The Company's primary business activity is coalbed methane gas property acquisition and exploration (and holding shut down mining properties) The Company has no producing mines. Other reportable industry segments include motel, real estate/airport operations, and contract drilling/construction activities. The following is information related to these industry segments:

U.S. ENERGY CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2001
(CONTINUED)

| Year Ended May 31, 2001 | | |
|--|-----------------------------------|---------------------------------------|
| Coalbed Methane (and holding costs for inactive | Motel/ Real Estate/ Airport | Contract Drilling/ Construction |

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| | mining properties) ----- | Operations ----- | Operations ----- |
|---|-----------------------------|-------------------------|-----------------------|
| Revenues | \$ 442,800 ===== | \$ 2,222,400 ===== | \$ 2,238,600 ===== |
| Other revenues | | | |
| Total revenues | | | |
| Operating (loss) profit | \$ (2,866,400) ===== | \$ (1,013,800) ===== | \$ 488,100 ===== |
| Other revenue, income and expenses | | | |
| General corporate and other expenses | | | |
| Equity in loss of affiliates and minority interest in subsidiaries | | | |
| Income before income taxes | | | |
| Identifiable net assets at May 31, 2001 | \$ 18,424,900 ===== | \$ 5,616,400 ===== | \$ 1,050,500 ===== |
| Investments in affiliates | | | |
| Corporate assets | | | |
| Total assets at May 31, 2001 | | | |
| Capital expenditures | \$ 1,280,200 ===== | \$ 1,326,800 ===== | \$ 256,000 ===== |
| Depreciation, depletion and amortization | \$ 129,700 ===== | \$ 271,100 ===== | \$ 324,700 ===== |

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U.S. ENERGY CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2001
(CONTINUED)

| | Year Ended May 31, 2000 ----- | | |
|----------------|---|--|--|
| | Coalbed Methane (and holding costs for inactive mining properties) ----- | Motel/ Real Estate/ Airport Operations ----- | Contract Drilling/ Construction Operations ----- |
| Revenues | \$ 132,600 ===== | \$ 2,734,800 ===== | \$ 3,584,900 ===== |
| Other revenues | | | |

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| | | | |
|---|----------------|--------------|--------------|
| Total revenues | | | |
| Operating (loss) profit | \$ (2,518,600) | \$ (652,500) | \$ (594,300) |
| | ===== | ===== | ===== |
| Other revenue, income and expenses | | | |
| General corporate and other expenses | | | |
| Equity in loss of affiliates and minority interest in subsidiaries | | | |
| Loss before income taxes | | | |
| Identifiable net assets at May 31, 2000 | \$ 17,543,700 | \$ 4,880,900 | \$ 2,163,300 |
| | ===== | ===== | ===== |
| Investments in affiliates | | | |
| Corporate assets | | | |
| Total assets at May 31, 2000 | | | |
| Capital expenditures | \$ 4,749,300 | \$ 944,600 | \$ 1,551,800 |
| | ===== | ===== | ===== |
| Depreciation, depletion and amortization | \$ 72,600 | \$ 148,100 | \$ 155,400 |
| | ===== | ===== | ===== |

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U.S. ENERGY CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2001
(CONTINUED)

| | | | |
|---|--|---|---|
| | Year Ended May 31, 1999 | | |
| | ----- | ----- | ----- |
| | Coalbed Methane (and holding costs for inactive mining properties) | Motel/ Real Estate/ Airport Operations | Contract Drilling/ Construction Operations |
| | ----- | ----- | ----- |
| Revenues | \$ 238,200 | \$ 2,882,800 | \$ -- |
| | ===== | ===== | ===== |
| Other revenues | | | |
| Total revenues | | | |
| Operating loss | \$ (2,071,600) | \$ (556,100) | \$ (14,800) |
| | ===== | ===== | ===== |
| Other revenue, income and expenses | | | |
| General corporate and other expenses | | | |
| Equity in loss of affiliates and minority interest in subsidiaries | | | |

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| | | | |
|------------------------------|---------------|--------------|------------|
| Loss before income taxes | | | |
| Identifiable net assets at | | | |
| May 31, 1999 | \$ 10,632,900 | \$ 8,107,300 | \$ 144,700 |
| | ===== | ===== | ===== |
| Investments in affiliates | | | |
| Corporate assets | | | |
| Total assets at May 31, 1999 | | | |
| Capital expenditures | \$ 725,400 | \$ 944,200 | \$ -- |
| | ===== | ===== | ===== |
| Depreciation, depletion and | | | |
| amortization | \$ 300,200 | \$ 348,600 | \$ 77,600 |
| | ===== | ===== | ===== |

During fiscal 1999, the \$238,200 in revenues were received from the sale of uranium purchased on the open market (none was produced from the Company's uranium properties, which are all shut down). There were no uranium sales during fiscal 2000.

J. SHAREHOLDERS' EQUITY:

The Board of Directors adopted the U.S. Energy Corp. 1989 Stock Option Plan (the "Option Plan") for the benefit of USE's key employees. The Option Plan, as amended, reserves 2,750,000 shares of the Company's \$.01 par value common stock for issuance under the Option Plan. During fiscal 1992, the Company issued 371,200 non-qualified options to certain of its executive officers, Board members and others at prices ranging from \$2.75 to \$2.90 per share. These options will expire on April 14, 2002 and April 30, 2002. During fiscal 1999, the Company issued 837,500 options under the Option Plan, including 299,462 non-qualified and 538,038 qualified options. The non-qualified options were issued at a price below fair market value, resulting in the recognition of \$262,000 in compensation expense at the time of issuance. During fiscal 2001, the Company issued 1,499,000 options under the Option Plan, including 918,763 non-qualified and 580,237 qualified options. Various employees exercised 118,703 of the outstanding options raising \$288,400 of capital.

U.S. ENERGY CORP. AND SUBSIDIARIES

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(CONTINUED)

The Board of Directors of USE adopted the U.S. Energy Corp. 1989 Employee Stock Ownership Plan ("ESOP") in 1989, for the benefit of USE employees. During fiscal 2001, 2000 and 1999, the Board of Directors of USE contributed 53,837, 123,802 and 89,600 shares to the ESOP at prices of \$5.35, \$3.00 and \$4.00 per share, respectively. The Company has recognized \$288,000, \$371,400 and \$358,400 in fiscal 2001, 2000 and 1999, respectively related to these contributions. USE has loaned the ESOP \$1,014,300 to purchase 125,000 shares from the Company and

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38,550 shares on the open market. These loans, which are secured by pledges of the stock purchased, bear interest at the rate of 10% per annum. The loans are reflected as unallocated ESOP contribution in the equity section of the accompanying Consolidated Balance Sheets.

In May 1996, the Board of Directors of USE approved an annual incentive compensation arrangement ("1996 Stock Award Program") for its CEO and four other officers of the Company payable in shares of the Company's common stock. The 1996 Stock Award Program was subsequently modified to reflect the intent of the directors which was to provide incentive to the officers of the Company to remain with USE. The shares are to be issued annually pursuant to the recommendation of the Compensation Committee on or before January 15 of each year, beginning January 15, 1997, as long as each officer is employed by the Company. The officers will receive up to an aggregate total of 67,000 shares per year for the years 1997 through 2002. The shares under the plan are forfeitable until retirement, death or disability of the officer. The shares are held in trust by the Company's treasurer and are voted by the Company's non-employee directors. As of May 31, 2001, 282,158 total shares have been issued to the five officers of the Company under the 1996 Stock Award Plan.

In December 1997, the Company entered into a warrant purchase agreement with an investment advisory firm to purchase 225,000 shares of the Company's common stock at an exercise price of \$10.50/share expiring December 2, 2000. The warrants were issued in exchange for services to be provided during the period from December 1997 to December 1998. The Company determined the fair value associated with these warrants to be \$186,000, which will be recognized ratably over the term of the related advisory agreement. Accordingly, \$108,000 was recognized as expense in fiscal 1998 and \$78,000 in fiscal 1999.

During fiscal 1998, the Company and YSFC entered into an Exchange Rights Agreement (the "Agreement"). Under the Agreement the YSFC private placement shareholders and related broker agent had the right, but not the obligation, to exchange their shares in YSFC for USE common stock if YSFC's common shares were not listed and available for quotation on the NASDAQ marketing system by March 1998. The Company exchanged 677,167 shares of its common stock during fiscal 1999, at a fair value of \$2,591,500, for 1,131,500 shares of YSFC common stock or 9% of the outstanding shares of YSFC. During fiscal 2000, the Company issued an additional 57,752 shares of its common stock valued at \$206,900 for an additional 96,250 shares of YSFC common stock or an additional 1% of the outstanding shares of YSFC common stock. The exchange rate for USE shares was the price paid for the YSFC's common shares plus 10% per annum return to the investor from the date of purchase. The number of USE shares exchanged was based on the exchange rate for a share of USE common stock for the five business days prior to the date of notice given by the YSFC shareholder to exchange their shares.

In January 1998, the Company entered into a warrant purchase agreement with another investment advisory firm to purchase 200,000 shares of the Company's common stock at an exercise price of \$7.50/share

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expiring January 20, 2000. The warrants were issued in exchange for services to be provided during the period from January 1998 to January 1999. The Company determined the fair value associated with these warrants to be \$264,000, which was recognized ratably over the term of the related advisory agreement. Accordingly, \$27,000 was recognized as an expense in fiscal 2000 and \$176,000 in fiscal 1999.

In February of 1999, the Company entered into a warrant purchase agreement with a consulting firm to purchase 20,000 shares of the Company's common stock at an exercise price of \$2.62 expiring January 31, 2002. The warrants were issued in exchange for services to be provided during the period from February 1999 to February 2000. The Company determined the fair value associated with these warrants to be \$36,000, which is recognized ratably over the term of the consulting agreement. Accordingly, \$9,000 was recognized as an expense in fiscal 1999 and \$27,000 in fiscal 2000.

Also, during fiscal 1999, the Company issued warrants in exchange for outstanding YSFC warrants, which were originally issued for services provided by outside consultants in connection with the agreement discussed above. The Company issued 67,025 warrants at an exercise price of \$3.64 expiring September 19, 2002. The Company determined the fair value associated with these warrants to be \$167,000, which was recorded as an additional investment in YSFC during fiscal 1999.

In February 1999, the Company entered into a consulting agreement with an individual to provide consulting and other services for a period of 24 months, commencing on February 8, 1999 and ending on January 31, 2001. As consideration for services to be performed, the Company granted the individual 25,000 shares of the Company's common stock at a grant price of \$2.75 per share and entered into a 5 year warrant purchase agreement to purchase up to 75,000 shares of the Company's common stock at an exercise price of \$2.25 per share, expiring February 8, 2004. The Company determined the fair value associated with the stock grant to be \$68,750 and the warrants to be \$140,000, which were recognized ratably over the term of the consulting agreement. Accordingly, \$69,550; \$104,400; and \$34,800 were recognized as an expense in fiscal 2001, 2000 and 1999, respectively related to this agreement.

During fiscal 2000, the Company issued 200 shares of its \$.01 par value mandatorily convertible preferred stock for \$2,000,000. A commission of \$160,000 was paid to an independent broker on this transaction. This preferred stock is mandatorily convertible into either 677,667 shares of common stock of RMG or into shares of common stock of the Company at the market price of the Company's common stock on the date of conversion. The preferred shares are convertible at the earlier of the date RMG completes an initial public offering of its common stock or April 11, 2002. The convertible preferred shares pay dividends at the rate of 7.5% per annum while they are outstanding. These preferred shares have been reflected outside of shareholders' equity in the accompanying consolidated balance sheets due to the convertible nature of the securities into common stock of RMG.

During fiscal 2001, the Company entered into a consulting agreement with a company to provide consulting and other services for a period of 18 months, commencing on May 14, 2001 and ending on November 14, 2002. As consideration for services to be performed, the Company issued the Company 15,000 shares of the Company's common stock at a grant price of \$4.70 per share and entered into two stock option agreements to purchase up to 10,000 shares of the Company's common stock at an exercise price of

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(CONTINUED)

\$4.70, expiring May 14, 2003. This option is exercisable upon the condition that the Company's common stock market price closes at or above \$6.50 per share for ninety (90) consecutive days prior to the expiration date of May 14, 2003. The fair value of this grant was estimated on the date of grant using the Black-Scholes options-pricing model with the following weighted-average assumptions used for the grants: expected dividends; expected volatility of 73%; risk-free interest rate of 4.29%; and expected life of two years. The exercise price of all options equaled or exceeded market price of the stock at the date of grant. The second option is to purchase 20,000 shares of the Company's common stock at an exercise price of \$4.70 per share will be granted to the Company if and when the Company's common stock market price closes at or above \$10.00 per share for ninety (90) consecutive days prior to its expiration date on May 14, 2003. The fair value of the option was \$19,780 which is being amortized over the service period.

The Company entered into two five year option Agreements on July 31, 2001, to allow outside consultants to purchase 80,000 shares of its common stock at \$4.30 per share. The Company determined that the value of the Options is \$52,144 which will be recognized as expense during fiscal 2002 to 2003. The fair value of this grant was estimated on the date of grant using the Black-Scholes options-pricing model with the following weighted-average assumptions used for the grants: no expected dividends; expected volatility of 73%; risk-free interest rate of 4.27%; and expected life of five years. The exercise price of all options equaled or exceeded market price of the stock at the date of grant.

The Board of Directors of the Company issues shares of stock as bonuses to certain directors, employees and third parties. The stock bonus shares have been reflected outside of the Shareholders' Equity section in the accompanying Consolidated Balance Sheets as such shares are forfeitable to the Company until earned. During fiscal 1993, the Company's Board of Directors amended the stock bonus plan. As a result, the earn-out dates of certain individuals were extended until retirement. For the years ended May 31, 2001, 2000 and 1999, the Company had compensation expense of \$358,500; \$201,000; and \$173,300, respectively, resulting from these issuances. A schedule of total forfeitable shares for the Company is set forth in the following table:

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U.S. ENERGY CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MAY 31, 2001

(CONTINUED)

| Issue Date ----- | Number of Shares ----- | Issue Price ----- | Total Compensation ----- |
|------------------------|------------------------------|-------------------------|--------------------------------|
| May 1990 | 40,300 | \$ 9.75 | \$ 392,900 |

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| | | | |
|----------------------------|----------|---------|--------------|
| June 1990 | 66,300 | 11.00 | 729,300 |
| November 1992 | 10,660 | N/A | N/A |
| May 1993 | 20,000 | 3.375 | 67,500 |
| November 1993 | 18,520 | 3.00 | 55,600 |
| January 1994 | 18,520 | 4.00 | 74,100 |
| January 1995 | 13,520 | 3.75 | 50,700 |
| February 1996 | 7,700 | 15.125 | 116,500 |
| December 1996 | 28,380 | 10.875 | 308,600 |
| December 1996 | 8,452 | 11.50 | 97,200 |
| August 1997 | 7,320 | 10.875 | 79,600 |
| August 1997 | 5,706 | 10.875 | 62,100 |
| May 1998 | 67,000 | 6.56 | 439,500 |
| | ----- | ----- | ----- |
| Balance at May 31, 1998 | 312,378 | | 2,473,600 |
| May 1999 | 67,000 | \$ 4.00 | 268,000 |
| Shares earned | (40,170) | -- | (269,900) |
| | ----- | ----- | ----- |
| Balance at May 31, 1999 | 339,208 | | 2,471,700 |
| May 2000 | 67,000 | \$ 3.00 | 201,000 |
| Shares earned | (9,600) | -- | (88,100) |
| | ----- | ----- | ----- |
| Balance at May 31, 2000 | 396,608 | | 2,584,600 |
| May 2001 | 67,000 | \$ 5.35 | 358,400 |
| Shares earned | (29,820) | -- | (194,400) |
| | ----- | ----- | ----- |
| Balance at May 31, 2001 | 433,788 | | \$ 2,748,600 |
| | ===== | | ===== |

During 2001, 2000 and 1999; 29,820, 9,600 and 40,170 shares were earned, respectively.

STATEMENT OF FINANCIAL ACCOUNTING STANDARDS NO. 123 ("SFAS 123")

SFAS 123, "Accounting for Stock-Based Compensation," defines a fair value based method of accounting for employee stock options or similar equity instruments. However, SFAS 123 allows the continued measurement of compensation cost for such plans using the intrinsic value based method prescribed by APB Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"), provided that pro forma disclosures are made of net income or loss and net income or loss per share, assuming the fair value based method of SFAS 123 had been applied. The Company has elected to account for its stock-based compensation plans under APB 25; accordingly, for purposes of the pro forma disclosures presented below,

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U.S. ENERGY CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2001
(CONTINUED)

the Company has computed the fair values of all options granted using the Black-Scholes pricing model and the following weighted average assumptions (no

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options were granted during 2000):

| | 2001 | 2000 | 1999 |
|-------------------------|-------|------|----------|
| | ---- | ---- | ---- |
| Risk-free interest rate | 4.29% | -- | 4.65% |
| Expected lives | -- | -- | 10 years |
| Expected volatility | 73.1% | -- | 102% |
| Expected dividend yield | -- | -- | 0% |

To estimate expected lives of options for this valuation, it was assumed options will be exercised upon expiration at the end of the ten years. All options are initially assumed to vest. Cumulative compensation cost recognized in pro forma net income or loss with respect to options that are forfeited prior to vesting is adjusted as a reduction of pro forma compensation expense in the period of forfeiture. Pro forma stock-based compensation, net of the effect of forfeitures, was \$2,746,600, \$0 and \$2,314,700 for 2001, 2000 and 1999, respectively.

If the Company had accounted for its stock-based compensation plans in accordance with SFAS 123, the Company's net loss and pro forma net loss per common share would have been reported as follows:

| | Year Ended May 31, | | |
|---------------------------------|--------------------|-----------------|-----------------|
| | 2001 | 2000 | 1999 |
| | ----- | ----- | ----- |
| Net loss to common shareholders | | | |
| As reported | \$ 1,771,200 | \$ (10,662,600) | \$ (11,648,500) |
| Pro forma | \$ (975,400) | \$ (10,662,600) | \$ (13,963,200) |
| Net loss per common share | | | |
| As reported, Basic | \$.23 | \$ (1.39) | \$ (1.63) |
| As reported, Diluted | \$.22 | \$ (1.33) | \$ (1.63) |
| Pro forma, Basic | \$ (.12) | \$ (1.39) | \$ (1.96) |
| Pro forma, Diluted | \$ (.12) | \$ (1.33) | \$ (1.96) |

Weighted average shares used to calculate pro forma net loss per share were determined as described in Note B, except in applying the treasury stock method to outstanding options, net proceeds assumed received upon exercise were increased by the amount of compensation cost attributable to future service periods and not yet recognized as pro forma expense.

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U.S. ENERGY CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MAY 31, 2001

(CONTINUED)

A summary of the Stock Option Plan activity for the years ended May 31, 2001 and 2000 is as follows:

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| | Year Ended May 31, | | | | Options |
|--|--------------------|---------------------------------|-----------|---------------------------------|-----------|
| | 2001 | | 2000 | | |
| | Options | Weighted Average Exercise Price | Options | Weighted Average Exercise Price | |
| Outstanding at beginning of year | 1,300,200 | 2.79 | 1,300,200 | 2.79 | 534,000 |
| Granted | 1,499,000 | 2.69 | -- | -- | 837,000 |
| Forfeited | (82,500) | 2.88 | -- | -- | (67,000) |
| Expired | (149,000) | 4.00 | -- | -- | -- |
| Exercised | (118,700) | 2.60 | -- | -- | (5,000) |
| Outstanding at end of year | 2,449,000 | 2.66 | 1,300,200 | 2.79 | 1,300,000 |
| Exercisable at end of year | 2,449,000 | 2.66 | 1,300,200 | 2.79 | 1,300,000 |
| Weighted average fair value of options granted during the year | | \$1.83 | | -- | |

The following table summarized information about employee stock options outstanding and exercisable at May 31, 2001:

| Weighted Average Exercise Price | Number of Options Outstanding at May 31, 2001 | Weighted Average Remaining Contractual Life in years | Number of Options Exercisable at May 31, 2001 |
|---------------------------------|---|--|---|
| \$2.00 | 291,800 | 7.33 | 291,800 |
| 2.69 | 1,430,000 | 8.62 | 1,430,000 |
| 2.75 | 31,400 | .92 | 31,400 |
| 2.88 | 462,500 | 7.33 | 462,500 |
| 2.90 | 233,300 | .87 | 233,300 |
| | 2,449,000 | | 2,449,000 |

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K. COMMITMENTS, CONTINGENCIES AND OTHER:

LEGAL PROCEEDINGS

SHEEP MOUNTAIN PARTNERS ARBITRATION/LITIGATION

The partners in SMP have been involved in a legal dispute over the past 10 years. After a ruling from the American Arbitration Association ("AAA") on the matter, in April 1996, Nukem, Inc., asked for and received a remand to the AAA Panel of the ruling. The Panel clarified its order on July 3, 1996. The Panel's Orders were confirmed by the U.S. District Court of Colorado and Nukem appealed to the 10th Circuit Court of Appeals ("CCA"). The CCA affirmed the lower Court's Judgment. Nukem moved for Satisfaction of Judgment which was denied by the District Court. Nukem again appealed but the 10th CCA ruled against Nukem and affirmed the lower Court's order holding that Nukem must account to Sheep Mountain Partners on the CIS contracts. The U.S. District Court has appointed a Special Master to determine the value of the purchase rights, the pounds of uranium purchased under those rights and the profits therefrom as ordered in the Judgment. The Special Master is currently conducting an accounting.

KENNECOTT LITIGATION

On November 10, 1999, Kennecott Uranium Company and Kennecott Energy Company ("Kennecott") filed a civil action against defendants U.S. Energy Corp., Crested Corp., and USECC in the Sixth Judicial District Court, Campbell County, Wyoming, No. 224006. On September 11, 2000, the parties entered into a settlement agreement to resolve all issues in the lawsuit. Under the settlement agreement, USECC sold all of its interests in the GMMV and the GMMV properties, to an affiliate of Kennecott. The purchase consideration was \$3,250,000 in cash and a 4% net profits royalty interest in certain of the mining claims at the Big Eagle and Jackpot Mines. Kennecott assumed all reclamation obligations on the GMMV properties.

SUTTER GOLD MINING COMPANY LITIGATION

On September 28, 1998, a lawsuit was filed in Amador County Superior Court, California by Concerned Citizens of Amador County as plaintiffs, against the County of Amador, the Amador County Board of Supervisors, and Sutter Gold Mining Company as a real party in interest. The lawsuit challenges the actions of Amador County and its Board of Supervisors in certifying the Final Subsequent Environmental Impact Report (FSEIR) and approving the amended Conditional Use Permit (CUP).

A hearing was held on June 7, 1999, and on August 30, 1999, the Honorable Susan C. Harlan, Judge of the Superior Court in Amador County, issued a detailed written Memorandum of Opinion, denying every cause of action of Appellants'/Petitioners' Petition for writ of Mandate, and upholding the County's certification of the FSEIR and approval of the amended CUP. In September 1999, the Concerned Citizens appealed Amador County Superior Court's decision to the Court of Appeals of the State of California Third Appellate District. On appeal, Appellants presented a more targeted approach, alleging only two violations of the Planning and Zoning Law and two violation of California Environmental Quality Act. SGMC and the

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2001
(CONTINUED)

County filed their respective Respondent Briefs. Oral arguments were made to the Appellate Court on August 20, 2001. A decision is expected soon.

CONTOUR DEVELOPMENT LITIGATION

On July 28, 1998, USE filed a lawsuit in the United States District Court, Denver, Colorado, Case No. 98WM1630, against Contour Development Company, L.L.C. and entities and persons associated with Contour Development Company, L.L.C. (together, "Contour") seeking compensatory and consequential damages of more than \$1.3 million from the defendants for dealings in real estate owned by USE and Crested in Gunnison, Colorado. The Contour defendants asserted a counter claim asking for payment of attorney's fees and costs. Discovery has been completed and the final pretrial conference is scheduled for October 2, 2001, when the court will schedule the trial date. Trial is expected in early 2002.

RECLAMATION AND ENVIRONMENTAL LIABILITIES

Most of the Company's exploration activities are subject to federal and state regulations that require the Company to protect the environment. The Company conducts its operations in accordance with these regulations. The Company's current estimates of its reclamation obligations and its current level of expenditures to perform ongoing reclamation may change in the future. At the present time, however, the Company cannot predict the outcome of future regulation or its impact on costs. Nonetheless, the Company has recorded its best estimate of future reclamation and closure costs based on currently available facts, technology and enacted laws and regulations. Certain regulatory agencies, such as the Nuclear Regulatory Commission ("NRC"), the Bureau of Land Management ("BLM") and the Wyoming Department of Environmental Quality ("WDEQ") review the Company's reclamation, environmental and decommissioning liabilities, and the Company believes its recorded amounts are consistent with those reviews and related bonding requirements. To the extent that planned production on its properties is delayed, interrupted or discontinued because of regulation or the economics of the properties, the future earnings of the Company would be adversely affected. The Company believes it has accrued all necessary reclamation costs and there are no additional contingent losses or unasserted claims to be disclosed or recorded. The Company has not disposed of any properties for which it has a commitment or is liable for any known environmental liabilities.

The majority of the Company's environmental obligations relate to former mining properties acquired by the Company. Since the Company currently does not have properties in production, the Company's policy of providing for future reclamation and mine closure costs on a unit-of-production basis has not resulted in any significant annual expenditures or costs. For the obligations recorded on acquired properties, including site-restoration, closure and monitoring costs, actual expenditures for reclamation will occur over several years, and since these properties are all considered future production properties, those expenditures, particularly the closure costs, may not be incurred for many years. The Company also does not believe that any significant capital expenditures to monitor or reduce hazardous substances or other environmental impacts are currently required. As a result, the near term reclamation obligations are not expected to have a significant impact on the Company's liquidity.

U.S. ENERGY CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 2001
(CONTINUED)

As of May 31, 2001, the Company has recorded estimated reclamation obligations of \$8,906,800 which is included in Reclamation and Other Long-term Liabilities in the accompanying Consolidated Balance Sheets. None of these liabilities have been discounted, and the Company has not recorded any potential offsetting recoveries from other responsible parties or from any insurance companies.

The Company currently has four mineral properties or investments that account for most of its environmental obligations, SMP, GMMV, Plateau and SGMC. The environmental obligations and the nature and extent of cost sharing arrangements with other potentially responsible parties, as well as any uncertainties with respect to joint and several liability of each are discussed in the following paragraphs:

SMP

The Company is responsible for the reclamation obligations, environmental liabilities and liabilities for injuries to employees in mining operations with respect to the Sheep Mountain properties. The reclamation obligations, which are established by regulatory authorities, were reviewed by the Company and the regulatory authorities during fiscal 2001 and they jointly determined that the reclamation liability was \$1,496,800. The obligation will be satisfied over the life of the mining project which is estimated to be at least 20 years. The Company self bonded this obligation by mortgaging certain of its real estate assets, including the Glen L. Larsen building, and by posting cash bonds.

GMMV

During fiscal 1991, the Company acquired developed mineral properties on Green Mountain known as the Big Eagle Property. The GMMV also acquired a uranium mill known as the Sweetwater Mill. As part of the settlement of the GMMV litigation with Kennecott in September 2000, the Company was released from any and all reclamation and environmental obligations related to the GMMV.

SUTTER GOLD MINING COMPANY

SGMC's mineral properties are shut down and have never been in production. There has been minimal surface disturbance on the Sutter properties. Reclamation obligations consist of closing the mine entry and removal of a mine shop. The reclamation obligation to close the property has been set by the State of California at \$27,800 which is covered by a cash reclamation bond. This amount

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was recorded by SGMC as a reclamation liability as of May 31, 2001.

PLATEAU RESOURCES, LIMITED

The environmental and reclamation obligations acquired with the acquisition of Plateau include obligations relating to the Shootaring Mill. Based on the bonding requirements, Plateau transferred \$2,500,000 to a trust account as financial surety to pay future costs of mill decommissioning, site reclamation and long-term site surveillance. In fiscal 1997, Plateau requested that the mill be placed on operational status.

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U.S. ENERGY CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MAY 31, 2001

(CONTINUED)

The NRC increased the reclamation liability to \$6,784,000 as a result of this request . As of May 31, 2001, a cash deposit for reclamation in the amount of \$9,664,000 was held by Plateau's escrow agent to satisfy the obligation of reclamation.

EXECUTIVE COMPENSATION

The Company is committed to pay the estates of certain of their officers one years' salary and an amount to be determined by the Boards of Directors, for a period of up to five years thereafter. This commitment applies only in the event of the death or total disability of those officers who are full-time employees of the Company at the time of total disability or death. Certain officers and employees have employment agreements with the Company.

L. DISCONTINUED OPERATIONS.

In February 1996, the Company completed the sale of 100% of the 8,267,450 outstanding shares of common stock of Brunton to a third party for \$4,300,000 in accordance with a Stock Purchase Agreement dated January 30, 1996 (the "Purchase Agreement"). The Company received \$300,000 at execution of the Purchase Agreement and approximately \$3,000,000 at closing. The Company has also since been paid in full on the \$1,000,000 balance. In addition, the Company was entitled to receive 45% of the profits before taxes as defined in the Purchase Agreement related to Brunton products existing at the time the Purchase Agreement was executed for a period of 4 years and three months, beginning February 1, 1996. The Company received payments of \$297,100, \$52,000, \$94,900 and \$292,600 for profits in 2001, 2000, 1999 and 1998, respectively.

M. SUBSEQUENT EVENT

Subsequent to May 31, 2001, the Company received \$796,000 for 199,000 shares of its restricted common stock through a private placement. The Company

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also received \$310,200 subsequent to May 31, 2001 as a result of employees exercising their options to purchase the Company's common stock.

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U.S. ENERGY CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS MAY 31, 2001 (CONTINUED)

N. SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

| | Three Months Ended | | |
|--|--------------------|----------------------|----------------------|
| | May 31, 2001 | February 28, 2001 | November 30, 2000 |
| Net Revenues | \$ 371,600 | \$ 650,600 | \$ 1,024,100 |
| Gross Profits | \$ (1,641,900) | \$ (2,024,100) | \$ (2,189,100) |
| Net Earnings (loss) | \$ (1,341,800) | \$ (1,857,800) | \$ 5,676,200 |
| Earnings (loss) per Share, basic | \$ (0.17) | \$ (0.24) | \$ 0.73 |
| Basic Weighted Average Shares Outstanding | 7,847,680 | 7,819,446 | 7,818,430 |
| Earnings (loss) per share, diluted | \$ (0.16) | \$ (0.23) | \$ 0.69 |
| Diluted Weighted Average Shares Outstanding | 8,243,135 | 8,216,054 | 8,215,038 |

| | Three Months Ended | | |
|----------------------------------|--------------------|----------------------|----------------------|
| | May 31, 2000 | February 28, 2000 | November 30, 1999 |
| Net Revenues | \$ 2,086,500 | \$ 1,793,700 | \$ 1,760,400 |
| Gross Profits | \$ (5,536,200) | \$ (2,796,800) | \$ (1,511,600) |
| Net Earnings (loss) | \$ (5,623,000) | \$ (2,610,400) | \$ (1,317,600) |
| Earnings (loss) per Share, basic | \$ (0.74) | \$ (0.39) | \$ (0.16) |

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| | | | |
|--|-----------|-----------|-----------|
| Basic Weighted Average Shares Outstanding | 7,697,569 | 8,021,781 | 7,258,291 |
| Earnings (loss)per share, diluted | \$ (0.75) | \$ (0.33) | \$ (0.16) |
| Diluted Weighted Average Shares Outstanding | 8,027,914 | 8,021,781 | 7,258,291 |

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REPORT OF INDEPENDENT CERTIFIED
PUBLIC ACCOUNTANTS ON SCHEDULE

To U.S. Energy Corp:

In connection with our audit of the consolidated financial statements of U.S. ENERGY CORP. (a Wyoming Corporation) AND SUBSIDIARIES referred to in our report dated July 27, 2001, which is included in the Company's annual report on Form 10-K, we have also audited Schedule II for the year ended May 31, 2001. In our opinion, this schedule presents fairly, in all material respects, the information to be set forth therein.

GRANT THORNTON LLP

Denver, Colorado
July 27, 2001

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U.S. ENERGY CORP.

SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS

| | Balance beginning of period ----- | Additions charged to expenses ----- | Deductions ----- | Balance end of period ----- |
|--------------|--|--|---------------------|-----------------------------------|
| May 31, 1999 | \$ 27,800 | \$ 465,000 | \$ 465,000 | \$ 27,800 ===== |
| May 31, 2000 | 27,800 | 708,600 | 708,600 | \$ 27,800 ===== |

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| | | | | |
|--------------|--------|----|----|--------------------|
| May 31, 2001 | 27,800 | -- | -- | \$ 27,800 ===== |
|--------------|--------|----|----|--------------------|

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

(a) During the previous eleven years, Arthur Andersen, LLP of Denver, Colorado was engaged as the independent accountant to audit the Company's financial statements. Arthur Andersen LLP has reported on all fiscal years from May 31, 1990 through May 31, 2000, and assisted in Management's review of the company's financial statements for the quarters ended August 31, 2000 and November 30, 2000. On September 8, 2000, the company's board of directors at the recommendation of its audit committee, ordered its Chief Financial Officer to seek bids from various accounting firms to conduct its annual audits.

(I) On January 31, 2001, Arthur Andersen LLP was advised by the Company that it had been replaced.

(II) Arthur Andersen LLP's audit reports for the last two fiscal years have not contained an adverse opinion or a disclaimer of opinion, and neither such report was qualified nor modified as to uncertainty, audit scope or accounting principles.

(III) The decision to change accountants was made by the board of directors.

(IV) During the two most recent fiscal years and during the interim period from May 31, 2000 to the date of replacement of independent accountant, there have been no disagreements with Arthur Andersen LLP on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure.

(V) Not applicable.

(b) On January 31, 2001, the Company engaged Grant Thornton LLP of Suite 1800, 1600 Broadway, Denver, Colorado 80202 as its new independent accountant, pursuant to the recommendation of the audit committee.

The concurrence letter from Arthur Andersen LLP was filed as an exhibit to the Form 8-K Report reporting the change in accountants, filed February 5, 2001.

PART III

In the event a definitive proxy statement containing the information being incorporated by reference into this Part III is not filed within 120 days of May 31, 2001, we will file such information under cover of a Form 10-K/A.

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.

The information required by Item 10 with respect to directors and certain executive officers is incorporated herein by reference to our Proxy Statement for the 2001 Annual Meeting of Shareholders, under the captions "Proposal 1: Election of Directors," "Filing of Reports Under Section 16(a)," and "Business

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Experience and Other Directorships of Directors and Nominees." The information regarding the remaining executive officers is contained in Part I of this report.

ITEM 11. EXECUTIVE COMPENSATION.

The information required by Item 11 is incorporated herein by reference to the Proxy Statement for the 2001 Annual Meeting of Shareholders, under the captions "Executive Compensation," and "Directors' Fees and Other Compensation."

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ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.

The information required by Item 12 is incorporated herein by reference to the Proxy Statement for the 2001 Annual Meeting of Shareholders, under the caption "Security Ownership of Certain Beneficial Owners and Management."

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

The information required by Item 13 is incorporated herein by reference to the Proxy Statement for the 2001 Annual Meeting of Shareholders, under the caption "Certain Relationships and Related Transactions."

ITEM 14. EXHIBITS, FINANCIAL STATEMENTS, SCHEDULES, REPORTS AND FORMS 8-K.

(1) The following financial statements are filed as a part of the Report in Item 8:

| Consolidated Financial Statements U.S. Energy Corp. and Subsidiaries | Page No. ----- |
|---|-------------------|
| Report of Independent Public Accountants Grant Thornton LLP..... | 47 |
| Report of Independent Public Accountants Arthur Andersen LLP..... | 48 |
| Consolidated Balance Sheets - May 31, 2001 and 2000..... | 49-50 |
| Consolidated Statements of Operations for the Years Ended May 31, 2001, 2000 and 1999..... | 51-52 |
| Consolidated Statements of Shareholders' Equity for the Years Ended May 31, 2001, 2000 and 1999..... | 53-55 |
| Consolidated Statements of Cash Flows for the Years Ended May 31, 2001, 2000 and 1999..... | 56-57 |
| Notes to Consolidated Financial Statements..... | 58-87 |
| Report of Independent Certified Public Accountants on Schedule..... | 88 |

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Schedule II - Valuation and Qualifying Accounts.....89

(2) Not applicable.

(3) Exhibits Required to be Filed. Each individual exhibit filed herewith is sequentially paginated corresponding to the pagination of the entire Form 10-K. As a result of this pagination, the page numbers of documents filed herewith containing a table of contents will not be the same as the page number contained in the original hard copy.

| Exhibit No. | Title of Exhibit | Sequential Page No. |
|----------------|--|------------------------|
| ----- | ----- | ----- |
| 3.1 | USE Restated Articles of Incorporation..... | [2] |
| 3.1(a) | USE Articles of Amendment to Restated Articles of Incorporation..... | [4] |
| 3.1(b) | USE Articles of Amendment (Second) to Restated Articles of Incorporation (Establishing Series A Convertible Preferred Stock..... | [9] |
| 3.2 | USE Bylaws, as amended through April 22, 1992..... | [4] |
| 4.1 | Amendment to USE 1998 Incentive Stock Option Plan (To include Family Transferability of Options Under SEC Rule 16b..... | [11] |
| 4.2 | USE 1998 Incentive Stock Option Plan and Form of Stock Option Agreement 1/99..... | [8] |
| 4.3 | USE Restricted Stock Bonus Plan, as amended through 2/94..... | [5] |
| 4.4 | Form of Stock Option Agreement, and Schedule Options Granted January 1, 1996..... | [6] |
| 4.5 | Form of Stock Option Agreement and Schedule, Options Granted January 10, 2001..... | [11] |
| 4.6 | [intentionally left blank) | |
| 4.7 | USE 1996 Officers' Stock Award Program (Plan)..... | [7] |
| 4.8 | USE Restated 1996 Officers' Stock Award Plan and Amendment to USE 1990 Restricted Stock Bonus Plan..... | [7] |
| 10.1 | USECC Joint Venture Agreement - Amended as of 1/20/89..... | [1] |
| 10.2 | Management Agreement with USECC..... | [3] |
| 10.3 | Professional Services Agreement and Option | |

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R. J. Falkner & Company, Inc.....11]

10.4 Professional Services Agreement and Warrant
Riches and Resources, Inc.....[11]

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10.5-10.60 [intentionally left blank]

10.61 Closing Agreement - Addendum to Agreement
for Purchase and Sale of Assets (see Exhibit 10.62).....[11]

10.62 Agreement for Purchase and Sale of Assets
(Rocky Mountain Gas, Inc. and Quantum Energy LLC).....[9]

10.63 Purchase and Sale Agreement
CCBM, Inc. (subsidiary of Carrizo Oil & Gas, Inc.)
and Rocky Mountain Gas, Inc.....[12]

16. Concurrence Letter from Arthur Andersen LLP
on Change of Accounting Firms.....[10]

21.1 Subsidiaries of Registrant.....[11]

99.1 Certification Pursuant to Section 1350 of Chapter 63
of Title 18 of the United States Code.....*

* Filed herewith.

Unless otherwise indicated, the SEC File Number for each of the following documents incorporated by reference is 000-6814.

- [1] Incorporated by reference from the like-numbered exhibit to the Registrant's Annual Report on Form 10-K for the year ended May 31, 1989, filed August 29, 1989.
- [2] Incorporated by reference from the like-numbered exhibit to the Registrant's Annual Report on Form 10-K for the year ended May 31, 1990, filed September 14, 1990.
- [3] Incorporated by reference from the like-numbered exhibit to the Registrant's Annual Report on Form 10-K for the year ended May 31, 1991, filed September 13, 1991.
- [4] Incorporated by reference from the like-numbered exhibit to the Registrant's Annual Report on Form 10-K for the year ended May 31, 1992, filed September 14, 1992.
- [5] Incorporated by reference from the like-numbered exhibit to the Registrant's Form S-1 registration statement, initial filing (SEC File No. 333-1689), filed June 18, 1996.
- [6] Incorporated by reference from the like-numbered exhibit to the Registrant's Annual Report on Form 10-K for the year ended May 31, 1996, filed September 13, 1996.

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- [7] Incorporated by reference from the like-numbered exhibit to the Registrant's Annual Report on Form 10-K for the year ended May 31, 1997, filed September 15, 1997.
- [8] Incorporated by reference from the like-numbered exhibit to the Registrant's Annual Report on Form 10-K for the year ended May 31, 1998, filed September 14, 1998.

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- [9] Incorporated by reference from the like-numbered exhibit to the Registrant's Form 10-K for the year ended May 31, 2000, filed September 13, 2000.
- [10] Incorporated by reference from the like-numbered exhibit to the Registrant's Form 8-K filed February 5, 2001.
- [11] Incorporated by reference from the like-numbered exhibit to the Registrant's Form 10-K for the year ended May 31, 2001, filed August 29, 2001.
- [12] Incorporated by reference from the like-numbered exhibit to the Registrant's Form 10-K/A amendment no. 1 for the year ended May 31, 2001, filed June 18, 2002.
- (b) Reports filed on Form 8-K.
- During the fourth quarter of the fiscal year ended on May 31, 2001, the Registrant filed no Form 8-K Reports.
- (c) Required exhibits are attached hereto and listed above under Item 14 (a) (3).
- (d) Required financial statement schedules are listed and attached hereto in Item 14(a) (2).

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this amended report to be signed on its behalf by the undersigned, thereunto duly authorized.

U.S. ENERGY CORP. (Registrant)

Date: January 13, 2003

By: /s/ John L. Larsen

John L. Larsen,

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Chief Executive Officer

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

Date: January 13, 2003 By: /s/ John L. Larsen

John L. Larsen, Director

Date: January 13, 2003 By: /s/ Keith G. Larsen

Keith G. Larsen, Director

Date: January 13, 2003 By: /s/ Harold F. Herorn

Harold F. Herron, Director

Date: January 13, 2003 By: /s/ Nick Bebout

Nick Bebout, Director

Date: January 13, 2003 By: /s/ H. Russell Fraser

H. Russell Fraser, Director

Date: January 13, 2003 By: /s/ Don C. Anderson

Don C. Anderson, Director

Date: January 13, 2003 By: /s/ Robert Scott Lorimer

Robert Scott Lorimer,
Principal Financial Officer/
Chief Accounting Officer

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CERTIFICATION

I, Robert Scott Lorimer, certify that:

1. I have reviewed this amended annual report on Form 10-K/A of U.S. Energy Corp.;

2. Based on my knowledge, this amended report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, misleading with respect to the period covered by this amended report.

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3. Based on my knowledge, the financial statements, and other financial information included in this amended report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this amended report.

DATED this 13th day of January 2003.

/s/ Robert Scott Lorimer

Robert Scott Lorimer
Chief Financial Officer

CERTIFICATION

I, John L. Larsen, certify that:

1. I have reviewed this amended annual report on Form 10-K/A of U.S. Energy Corp.;
2. Based on my knowledge, this amended report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, misleading with respect to the period covered by this amended report.
3. Based on my knowledge, the financial statements, and other financial information included in this amended report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this amended report.

DATED this 13th day of January 2003.

/s/ John L. Larsen

John L. Larsen,
Chief Executive Officer