AMERICAN REAL ESTATE PARTNERS L P
Form 8-K/A
September 15, 2005

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

FORM 8-K/A

CURRENT REPORT
Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934

Date of Report (Date of Earliest Event Reported): June 29, 2005

American Real Estate Partners, L.P.

(Exact name of registrant as specified in its charter)

Delaware	**1-9516**	**13-3398766**
(State or other jurisdiction of incorporation)	(Commission File Number)	(IRS Employer Identification No.)

100 South Bedford Road, Mt. Kisco, NY	10549
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: **(914) 242-7700**

N/A

(Former name or former address, if changed since last report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

o Written communication pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

o Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

o Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

o Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

On July 6, 2005, we filed a Form 8-K under Item 2.01 to report the completion of the acquisitions of Panaco, Inc., a membership interest in NEG Holding LLC and securities of GB Holdings, Inc. and Atlantic Coast Entertainment Holdings, Inc. In response to parts (a) and (b) of Item 9.01 of such Form 8-K, we stated that we would file the required financial information by amendment, as permitted by Item 9.01. This Form 8-K amendment is being filed to provide the financial statements of NEG Holding LLC, Panaco, Inc., GB Holdings, Inc. and Atlantic Coast Entertainment Holdings, Inc. and pro forma financial data for American Real Estate Partners, L.P.

Section 9 Financial Statements and Exhibits

Item 9.01 Financial Statements and Exhibits

(a) Financial statements of businesses acquired.

The following financial statements of NEG Holding LLC, Panaco, Inc., GB Holdings, Inc. and Atlantic Coast Entertainment Holdings, Inc. are filed on the pages listed below.

(b) Pro forma financial information.

The following required pro forma financial data are filed on the pages listed below.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Members
NEG Holding LLC:

We have audited the accompanying consolidated balance sheet of NEG Holding LLC (the Company) and subsidiaries as of December 31, 2004, and the related consolidated statement of operations, members equity and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of NEG Holding LLC and subsidiaries as of December 31, 2004, 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.

/s/ Grant Thornton LLP

Houston, Texas
March 4, 2005

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Members
NEG Holding LLC:

We have audited the accompanying consolidated balance sheet of NEG Holding LLC (the Company) and subsidiaries as of December 31, 2003, and the related consolidated statements of operations, members equity and cash flows for each of the years in the two-year period ended December 31, 2003. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of NEG Holding LLC and subsidiaries as of December 31, 2003, and the results of their operations and their cash flows for each of the years in the two-year period ended December 31, 2003, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 8 to the consolidated financial statements, effective January 1, 2003, the Company changed its method of accounting for asset retirement obligations.

/s/ KPMG LLP

Dallas, Texas
March 12, 2004

NEG HOLDING LLC
CONSOLIDATED BALANCE SHEETS

	December 31, 2004	December 31, 2003
ASSETS		
Current assets:		
Cash and cash equivalents	$ 882,841	$ 15,401,433
Accounts receivable oil and natural gas sales	18,220,105	13,214,537
Accounts receivable joint interest and other (net of allowance of $104,000 in 2004 & 2003)	495,272	485,083
Notes receivable other (net of allowance of $790,000 in 2004)	489,389	1,220,960
Derivative broker deposit		1,700,000
Drilling prepayments	858,114	1,106,871
Other	2,200,156	286,399
Total current assets	23,145,877	33,415,283
Oil and natural gas properties, at cost (full cost method):		
Subject to ceiling limitation	573,069,515	507,250,803
Accumulated depreciation, depletion, and amortization	(343,485,274)	(322,443,045)
Net oil and natural gas properties	229,584,241	184,807,758
Other property and equipment	5,055,490	4,838,114
Accumulated depreciation	(4,063,781)	(3,746,317)
Net other property and equipment	991,709	1,091,797
Note receivable	3,090,000	1,827,000
Equity investment	2,379,108	1,698,000
Other long term assets	1,082,504	964,500
Total assets	$ 260,273,439	$ 223,804,338
LIABILITIES AND MEMBERS EQUITY		
Current liabilities:		
Accounts payable trade	$ 10,239,384	$ 2,879,138
Accounts payable affiliate	1,595,235	411,731
Accounts payable revenue	4,104,029	3,964,530
Prepayments from partners	90,186	265,871
Other	77,593	136,707
Derivative financial instruments	6,349,714	6,595,475
Total current liabilities	22,456,141	14,253,452

Long term liabilities:				
Note payable		83,031		592,889
Gas balancing		897,852		818,621
Credit facility		51,833,624		43,833,624
Asset retirement obligation		3,055,240		3,268,381
Derivative financial instruments		7,766,144		
Members equity		174,181,407		161,037,371
Total liabilities and members equity	$	260,273,439	$	223,804,338

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

NEG HOLDING LLC
CONSOLIDATED STATEMENTS OF OPERATIONS

	Year Ended December 31,		
	2004	2003	2002
Revenues:			
Oil and natural gas sales	$ 76,677,224	$ 75,740,373	$ 35,319,918
Field operations	326,960	297,069	403,933
Plant operations	1,723,305	1,568,502	177,049
Total revenue	78,727,489	77,605,944	35,900,900
Costs and expenses:			
Lease operating	13,505,366	11,501,303	8,508,744
Field operations	334,443	397,669	420,188
Plant operations	680,066	577,003	68,767
Oil and natural gas production taxes	5,732,265	5,770,865	1,874,854
Depreciation, depletion and amortization	21,385,529	23,442,797	15,509,106
Accretion of asset retirement obligation	261,471	242,752	
Amortization of loan cost	494,386		
General and administrative	4,919,525	4,833,546	5,682,804
Total costs and expenses	47,313,051	46,765,935	32,064,463
Operating income	31,414,438	30,840,009	3,836,437
Other income (expense):			
Interest expense	(2,222,009)	(1,538,048)	(96,491)
Interest income and other, net	299,327	472,337	1,245,204
Interest income from affiliate	149,650	114,867	546,228
Commitment fee income		125,000	175,000
Equity in loss on investment	(518,892)	(102,000)	
Dividend expense			(145,200)
Gain (loss) on sale of securities		(953,790)	8,711,915
Unrealized loss on financial instruments/short sale			(346,992)
Income before cumulative effect of change in accounting principle	29,122,514	28,958,375	13,926,101
Cumulative effect of change in accounting principle		1,911,705	
Net income	$ 29,122,514	$ 30,870,080	$ 13,926,101

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

NEG HOLDING LLC
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2004	**2003**	**2002**
Operating Activities			
Net income	$ 29,122,514	$ 30,870,080	$ 13,926,101
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation, depletion and amortization	21,385,529	23,442,797	15,509,106
Change in fair market value of derivative contracts	7,520,383	2,987,013	3,608,462
Unrealized loss on financial instruments/short sale			346,992
Gain (loss) on sale of assets	(6,136)		7,058
Equity in loss on investment	518,892	102,000	
Accretion of asset retirement obligation	261,471	242,752	
Provision for doubtful account	790,000		
Amortization of note costs	494,386		
Cumulative effect of change in accounting principle		(1,911,705)	
Changes in operating assets and liabilities:			
Accounts receivable	(5,078,989)	(1,296,013)	(2,069,815)
Notes receivable	(1,258,198)	(1,831,802)	(2,774,968)
Drilling prepayments	248,758	(380,288)	(457,565)
Derivative broker deposit	1,700,000	100,000	(1,800,000)
Other current assets	(2,086,257)	(26,215)	912,577
Accounts payable and accrued liabilities	8,017,822	493,730	(566,450)
Net cash provided by operating activities	61,630,175	52,792,349	26,641,498
Investing Activities			
Oil and natural gas exploration and development expenditures	(67,487,412)	(36,034,277)	(18,106,385)
Longfellow Ranch acquisition			(51,037,347)
Purchases of other property and equipment	(245,250)	(149,897)	(222,039)
Increase in restricted cash			(346,992)
Proceeds from sales of oil and natural gas properties	1,202,263	1,436,016	1,434,212
Equity investment	(1,200,000)	(1,800,000)	
Net cash used in investing activities	(67,730,399)	(36,548,158)	(68,278,551)
Financing Activities			
Proceeds from Arnos credit facility		46,756,377	
Repayment of Arnos credit facility		(46,756,377)	
Proceeds from Mizuho credit facility	8,000,000	43,833,624	

Loan issuance costs		(439,890)		(951,697)		
Guaranteed Payment to member		(15,978,478)		(18,228,781)		(21,652,819)
Priority Amount distribution to member				(40,506,072)		
Net cash used in financing activities		(8,418,368)		(15,852,926)		(21,652,819)
Increase (decrease) in cash and cash equivalents		(14,518,592)		391,265		(63,289,872)
Cash and cash equivalents at beginning of period		15,401,433		15,010,168		78,300,040
Cash and cash equivalents at end of period	$	882,841	$	15,401,433	$	15,010,168
Supplemental Cash Flow Information						
Interest paid in cash	$	1,713,136	$	1,537,127	$	96,491
Distribution of member note payable	$		$	10,939,750	$	

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

NEG HOLDING LLC
CONSOLIDATED STATEMENTS OF MEMBERS EQUITY

		Members Equity
Balance at December 31, 2001	$	207,568,612
Guaranteed Payment to member		(21,652,819)
Net income		13,926,101
Balance at December 31, 2002	$	199,841,894
Guaranteed Payment to member		(18,228,781)
Priority Amount distribution to member		(51,445,822)
Net income		30,870,080
Balance at December 31, 2003	$	161,037,371
Guaranteed Payment to member		(15,978,478)
Net income		29,122,514
Balance at December 31, 2004	$	174,181,407

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

NEG HOLDING LLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2004

1. Background

NEG Holding LLC (the Company), a Delaware limited liability company, was formed in August 2000. Start up costs of the Company were incurred by Gascon Partners (Gascon) and were not significant. No other activity occurred from August 2000 until the members contributions in September 2001. In exchange for an initial 50% membership interest in the Company, on September 12, 2001, but effective as of May 1, 2001, National Energy Group, Inc. (NEG) contributed to the Company all of its operating assets and oil and natural gas properties. In exchange for its initial 50% membership interest in the Company, Gascon contributed its sole membership interest in Shana National LLC, an oil and natural gas producing company, and cash, including a $10.9 million Revolving Note issued to Arnos Corp. (Arnos), evidencing the borrowings under the NEG revolving credit facility. In connection with the foregoing, the Company initially owns 100% of the membership interest in NEG Operating LLC (Operating LLC), a Delaware limited liability company. Gascon is currently the managing member of the Company. All of the oil and natural gas assets contributed by NEG and all of the oil and natural gas assets associated with Gascon s contribution to the Company were transferred from the Company to Operating LLC on September 12, 2001, but effective as of May 1, 2001. Allocation of membership interest in the Company was based principally on the estimated fair value of the assets contributed as of May 1, 2001, with each member contributing assets of equal fair value. The following summarizes the historical book carrying value of the net assets contributed as of September 1, 2001.

	National Energy Group, Inc.	Gascon	Total
Current assets	$ 11,535,745	$ 97,183,477	$ 108,719,222
Net oil and natural gas properties	84,983,139	30,573,625	115,556,764
Hedge assets	4,807,689		4,807,689
Intercompany receivable		4,783,737	4,783,737
Total assets	$ 101,326,573	$ 132,540,839	$ 233,867,412
Current liabilities	$ 4,157,430	$ 2,657,190	$ 6,814,620
Long-term liabilities	940,033	1,377,782	2,317,815
Intercompany payable	4,783,737		4,783,737
Members equity	91,445,373	128,505,867	219,951,240
Total liabilities and members equity	$ 101,326,573	$ 132,540,839	$ 233,867,412

The Holding LLC Operating Agreement entered into on September 12, 2001, contains a provision that allows Gascon at any time, in its sole discretion, to redeem NEG s membership interest in the Company at a price equal to the fair market value of such interest determined as if the Company had sold all of its assets for fair market value and liquidated.

The Company shall be dissolved and its affairs wound up in accordance with the Delaware Limited Liability Company Act and the Holding LLC Operating Agreement on December 31, 2024, unless the Company shall be dissolved sooner and its affairs wound up in accordance with the Delaware Limited Liability Company Act or the Holding LLC Operating Agreement.

NEG HOLDING LLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. Significant Accounting Policies

Consolidation

The consolidated financial statements include the accounts of the Company, and its sole subsidiary Operating LLC. All significant intercompany transactions and balances have been eliminated.

Accounting Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that 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 these estimates.

Cash and Cash Equivalents

Cash and cash equivalents may include demand deposits, short-term commercial paper, and/or money-market investments with maturities of three months or less when purchased.

Oil and Natural Gas Properties

The Company utilizes the full cost method of accounting for its crude oil and natural gas properties. Under the full cost method, all productive and nonproductive costs incurred in connection with the acquisition, exploration, and development of crude oil and natural gas reserves are capitalized and amortized on the units-of-production method based upon total proved reserves. The costs of unproven properties are excluded from the amortization calculation until the individual properties are evaluated and a determination is made as to whether reserves exist. Conveyances of properties, including gains or losses on abandonments of properties, are treated as adjustments to the cost of crude oil and natural gas properties, with no gain or loss recognized.

Under the full cost method, the net book value of oil and natural gas properties, less related deferred income taxes, may not exceed the estimated after-tax future net revenues from proved oil and natural gas properties, discounted at 10% per year (the ceiling limitation). In arriving at estimated future net revenues, estimated lease operating expenses, development costs, abandonment costs, and certain production related and ad-valorem taxes are deducted. In calculating future net revenues, prices and costs in effect at the time of the calculation are held constant indefinitely, except for changes which are fixed and determinable by existing contracts. The net book value is compared to the ceiling limitation on a quarterly basis. The excess, if any, of the net book value above the ceiling limitation is required to be written off as a non-cash expense. The Company did not incur a ceiling writedown in 2002, 2003 and 2004. There can be no assurance that there will not be writedowns in future periods under the full cost method of accounting as a result of sustained decreases in oil and natural gas prices or other factors.

The Company has capitalized internal costs of $1.0 million, $0.6 million, and $0.6 million for the years ended December 31, 2004, 2003 and 2002, respectively, as costs of oil and natural gas properties. Such capitalized costs include salaries and related benefits of individuals directly involved in the Company s acquisition, exploration, and development activities based on a percentage of their salaries.

The Company is subject to extensive federal, state, and local environmental laws and regulations. These laws, which are constantly changing, regulate the discharge of materials into the environment and may require the Company to remove or mitigate the environment effects of the disposal or release of petroleum or chemical substances at various sites. Environmental expenditures are expensed or capitalized depending on their future economic benefit. Expenditures that relate to an existing condition caused by past operations and that have no future economic benefits are expensed. Liabilities for expenditures of a noncapital nature are

NEG HOLDING LLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

recorded when environmental assessment and/or remediation is probable, and the costs can be reasonably estimated.

The Company s operations are subject to all of the risks inherent in oil and natural gas exploration, drilling and production. These hazards can result in substantial losses to the Company due to personal injury and loss of life, severe damage to and destruction of property and equipment, pollution or environmental damage, or suspension of operations. The Company maintains insurance of various types customary in the industry to cover its operations and believes it is insured prudently against certain of these risks. In addition, the Company maintains operator s extra expense coverage that provides coverage for the care, custody and control of wells drilled by the Company. The Company s insurance does not cover every potential risk associated with the drilling and production of oil and natural gas. As a prudent operator, the Company does maintain levels of insurance customary in the industry to limit its financial exposure in the event of a substantial environmental claim resulting from sudden and accidental discharges. However, 100% coverage is not maintained. The occurrence of a significant adverse event, the risks of which are not fully covered by insurance, could have a material adverse effect on the Company s financial condition and results of operations. Moreover, no assurance can be given that the Company will be able to maintain adequate insurance in the future at rates it considers reasonable. The Company believes that it operates in compliance with government regulations and in accordance with safety standards which meet or exceed industry standards.

Other Property and Equipment

Other property and equipment includes furniture, fixtures, and other equipment. Such assets are recorded at cost and are depreciated over their estimated useful lives using the straight-line method.

The Company s investment in Longfellow Ranch Field includes a minority interest in a gas separation facility. This investment is included in the oil and natural gas properties and depleted over the life of the reserves.

Maintenance and repairs are charged against income when incurred; renewals and betterments, which extend the useful lives of property and equipment, are capitalized.

Income Taxes

The Company will be taxed as a partnership under federal and applicable state laws; therefore, the Company has not provided for federal or state income taxes since these taxes are the responsibility of the Members.

Financial Instruments

The Company sells crude oil and natural gas to various customers. In addition, the Company participates with other parties in the operation of crude oil and natural gas wells. Substantially all of the Company s accounts receivable are due from either purchasers of crude oil and natural gas or participants in crude oil and natural gas wells for which the Company serves as the operator. Generally, operators of crude oil and natural gas properties have the right to offset future revenues against unpaid charges related to operated wells. Crude oil and natural gas sales are generally unsecured.

Accounts Receivable

The allowance for doubtful accounts is maintained at an adequate level to absorb losses in the Company s accounts receivable. Our management continually monitors the accounts receivable from customers for any collectability issues. An allowance for doubtful accounts is established based on reviews of individual customer accounts, recent loss experience, current economic conditions, and other pertinent factors. Accounts deemed

NEG HOLDING LLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

uncollectible are charged to the allowance. Provisions for bad debts and recoveries on accounts previously charge-off are added to the allowance.

Allowances for bad debt totaled approximately $.9 million at December 31, 2004 and $.1 million at December 31, 2003. At December 31, 2004, the carrying value of the Company s accounts receivable approximates fair value.

Revenue Recognition

Revenues from the sale of natural gas and oil produced are recognized upon the passage of title, net of royalties.

Natural Gas Production Imbalances

The Company accounts for natural gas production imbalances using the sales method, whereby the Company recognizes revenue on all natural gas sold to its customers notwithstanding the fact that its ownership may be less than 100% of the natural gas sold. Liabilities are recorded by the Company for imbalances greater than the Company s proportionate share of remaining estimated natural gas reserves.

Comprehensive Income

Comprehensive income is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. There were no differences between net earnings and total comprehensive income in 2004, 2003 and 2002.

Derivatives

The Company follows SFAS No. 133, *Accounting for Certain Derivative Instruments and Certain Hedging Activities* and SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activity, an Amendment of SFAS 133* that requires that all derivative instruments be recorded on the balance sheet at their respective fair value.

Prior to contributing all oil and natural gas assets to the Company, NEG periodically managed its exposure to fluctuations in oil and natural gas prices by entering into various derivative instruments consisting principally of collar options and swaps. NEG elected not to designate these instruments as hedges for accounting purposes, accordingly the change in unrealized gains and losses is included in oil and natural gas sales. Cash settlements and valuation losses are included in oil and natural gas sales. The Company has accounted for these instruments in the same manner. The following summarizes the cash settlements and unrealized gains and losses for the years ended December 31, 2004, 2003 and 2002:

	2004	2003	2002
Gross cash receipts	$ 1,327,200	$ 14,924	$ 1,246,080
Gross cash payments	$ 13,694,010	$ 8,681,198	$ 2,430
Valuation loss	$ 7,520,383	$ 2,987,013	$ 3,608,462

While the use of derivative contracts can limit the downside risk of adverse price movements, it may also limit future gains from favorable movements. The Company addresses market risk by selecting instruments whose value fluctuations correlate strongly with the underlying commodity. Credit risk related to derivative activities is managed by requiring minimum credit standards for counterparties, periodic settlements, and mark to market valuations.

The Company received various commodity swap agreements (contracts) from Gascon and NEG as part of their initial contribution of assets and liabilities in September 2001. The counterparty to these

NEG HOLDING LLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

instruments was through Enron North America Corp. As of December 2001, Enron Corp. and Enron North America Corp. et al (Enron) filed for protection under Chapter 11, Title 18 of the United States Code. Enron ceased making payments under the various contracts in November 2001, prior to the bankruptcy filings. Accordingly, each of the contracts shall be administered as a claim filed by the Company in the Enron bankruptcy proceedings. The Company estimates its claim against Enron related to these contracts is approximately $7.25 million. The $7.25 million claim represented a hedge against future oil and natural gas prices and did not reflect a cash gain or loss on the contracts. For this reason, no asset or liability was recorded at December 31, 2001 and the Company recorded a net non cash valuation loss of $4.6 million through December 31, 2001 in connection with these contracts. The Company cannot predict what amount, if any may be ultimately received in the Enron bankruptcy proceeding.

The following is a summary of the oil and natural gas no-cost commodity price collars entered into with Shell Trading Company:

Date of Contract	Volume/Month	Production Month	Floor	Ceiling
August 2002	30,000 Bbls	2003	$ 23.55	$ 26.60
August 2002	300,000 MMBTU	2003	$ 3.25	$ 4.62
November 2002	300,000 MMBTU	2003	$ 3.50	$ 4.74
November 2002	300,000 MMBTU	2004	$ 3.35	$ 4.65
November 2002	300,000 MMBTU	2005	$ 3.25	$ 4.60
November 2003	45,000 Bbls	2004	$ 26.63	$ 29.85
February 2005	16,000 Bbls	2006	$ 41.75	$ 45.40
February 2005	120,000 MMBTU	2006	$ 6.00	$ 7.28

On January 28, 2003, the Company entered into an eleven month fixed price swap agreement with Plains Marketing, L.P., consisting of a contract for 28,000 barrels of oil per month at a fixed price of $28.35 effective February 2003 through December 2003.

The following is a summary of oil and natural gas contracts entered into with Bank of Oklahoma on January 6, 2004 and November 15, 2004.

Type Contract	Production Month	Volume per	Fixed Price	Floor	Ceiling
Fixed price	February - March 2004	400,000 MMBTU	$ 6.915	$	$
Fixed price	April - June 2004	400,000 MMBTU	$ 5.48	$	$
Fixed price	July - September 2004	400,000 MMBTU	$ 5.38	$	$
No Cost Collars	October - December 2004	400,000 MMBTU	$	$ 5.25	$ 5.85
No Cost Collars	2005	300,000 MMBTU	$	$ 4.75	$ 5.45
No Cost Collars	2006	500,000 MMBTU	$	$ 4.50	$ 5.00
No Cost Collars	2005	250,000 MMBTU	$	$ 6.00	$ 8.70
No Cost Collars	2005	25,000 Bbls	$	$ 43.60	$ 45.80

A liability of $6.6 million and $14.1 million ($6.3 million as current, $7.8 million as long-term) was recorded by the Company as of December 31, 2003 and 2004 respectively, in connection with these contracts. The Company had $1.7 and $0.0 million on deposit with Shell Trading as of December 31, 2003 and 2004, respectively, to collateralize the contracts. As of December 31, 2004, the Company had issued $11.0 million in letters of credit to Shell for this purpose.

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NEG HOLDING LLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Recent Accounting Pronouncements

On September 28, 2004, the SEC released Staff Accounting Bulletin (SAB) 106 regarding the application of SFAS 143, Accounting for Asset Retirement Obligations (AROs), by oil and gas producing companies following the full cost accounting method. Pursuant to SAB 106, oil and gas producing companies that have adopted SFAS 143 should exclude the future cash outflows associated with settling AROs (ARO liabilities) from the computation of the present value of estimated future net revenues for the purposes of the full cost ceiling calculation. In addition, estimated dismantlement and abandonment costs, net of estimated salvage values, that have been capitalized (ARO assets) should be included in the amortization base for computing depreciation, depletion and amortization expense. Disclosures are required to include discussion of how a company s ceiling test and depreciation, depletion and amortization calculations are impacted by the adoption of SFAS 143. SAB 106 is effective prospectively as of the beginning of the first fiscal quarter beginning after October 4, 2004. The adoption of SAB 106 is not expected to have a material impact on either the ceiling test calculation or depreciation, depletion and amortization.

On December 16, 2004, the FASB issued Statement 123 (revised 2004), Share-Based Payment that will require compensation costs related to share-based payment transactions (e.g., issuance of stock options and restricted stock) to be recognized in the financial statements. With limited exceptions, the amount of compensation cost will be measured based on the grant-date fair value of the equity or liability instruments issued. In addition, liability awards will be remeasured each reporting period. Compensation cost will be recognized over the period that an employee provides service in exchange for the award. Statement 123(R) replaces SFAS 123, Accounting for Stock-Based Compensation, and supersedes Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees. For us, SFAS 123(R) is effective for the first reporting period after June 15, 2005. Entities that use the fair-value-based method for either recognition or disclosure under SFAS 123 are required to apply SFAS 123(R) using a modified version of prospective application. Under this method, an entity records compensation expense for all awards it grants after the date of adoption. In addition, the entity is required to record compensation expense for the unvested portion of previously granted awards that remain outstanding at the date of adoption. In addition, entities may elect to adopt SFAS 123(R) using a modified retrospective method where by previously issued financial statements are restated based on the expense previously calculated and reported in their pro forma footnote disclosures. The company had no share based payments subject to this standard.

On December 16, 2004, the FASB issued Statement 153, Exchanges of Nonmonetary Assets , an amendment of APB Opinion No. 29, to clarify the accounting for nonmonetary exchanges of similar productive assets. SFAS 153 provides a general exception from fair value measurement for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The Statement will be applied prospectively and is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The Company does not have any nonmonetary transactions for any period presented that this Statement would apply.

3. Management Agreement

The management and operation of Operating LLC is being undertaken by NEG pursuant to the Management Agreement which NEG has entered into with Operating LLC. The strategic direction of Operating LLC s oil and natural gas business, including oil and natural gas drilling and capital investments, is controlled by the managing member of the Company (currently Gascon). The Management Agreement provides that NEG will manage Operating LLC s oil and natural gas assets and business until the earlier of November 1, 2006, or such time as Operating LLC no longer owns any of the managed oil and natural gas properties. NEG s employees will conduct the day-to-day operations of Operating LLC s oil and natural gas properties, and all costs and expenses incurred in the operation of the oil and natural gas properties shall be

NEG HOLDING LLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

borne by Operating LLC, although the Management Agreement provides that the salary of NEG s Chief Executive Officer shall be 70% attributable to the managed oil and natural gas properties, and the salaries of each of the General Counsel and Chief Financial Officer shall be 20% attributable to the managed oil and natural gas properties.

In exchange for NEG s management services, Operating LLC shall pay NEG a management fee of 115% of the actual direct and indirect administrative and reasonable overhead costs incurred by NEG in operating the oil and natural gas properties which either NEG, or Operating LLC may seek to change within the range of 110%-115% as such change is warranted; however, the parties have agreed to consult with each other to ensure that such administrative and reasonable overhead costs attributable to the managed properties are properly reflected in the management fee paid to NEG. In addition, Operating LLC has agreed to indemnify NEG to the extent it incurs any liabilities in connection with its operation of the assets and properties of Operating LLC, except to the extent of its gross negligence, or misconduct. The Company recorded $6.2 million, $6.6 million and $7.6 million as a management fee to NEG for the years ended December 31, 2004, 2003 and 2002. These amounts are included in general and administrative and lease operating expenses.

4. Acquisitions

In November 2002, the Company completed the acquisition of producing oil and natural gas properties in Pecos County, Texas known as Longfellow Ranch Field. The consideration for this acquisition consisted of $45.4 million in cash, which was funded from available cash.

In December 2002, the Company completed the acquisition of additional interest in Longfellow Ranch Field in Pecos County, Texas. The consideration for this acquisition consisted of $2.9 million in cash, which was funded from available cash.

The following pro forma data presents the results of the Company for the year ended 2002, as if the acquisition of properties had occurred on January 1, 2002. The pro forma results of operations are presented for comparative purposes only and are not necessarily indicative of the results which would have been obtained had the acquisition been consummated as presented. The following data reflect pro forma adjustments for the oil and natural gas revenues, production costs, and depreciation and depletion related to the properties (in thousands).

NEG HOLDING LLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Pro Forma Year Ended December 31, 2002 (Unaudited)
Revenues:	
Oil and natural gas sales	$ 47,659
Plant operations	1,515
Field operations	404
Total revenue	49,578
Costs and expenses:	
Oil and natural gas production taxes	(2,414)
Lease operating	(12,250)
Depreciation and depletion	(20,206)
Plant operations expense	(529)
Field operations	(420)
General and administrative	(5,683)
Total expense	(41,502)
Operating income	$ 8,076
Net income	$ 14,557

5. Investments/Note Receivable

In January 2002, the Company acquired stock valued at $49.95 million, which was sold at a gain of $8.7 million in February 2002. In an unrelated transaction, the Company completed a short sale of stock in November 2002 for $10.4 million. At December 31, 2002, this short sale position remained open and the mark-to-market value of such stock resulted in an unrealized loss of $0.3 million. In January 2003, the Company settled this position and recorded a loss of $1.0 million on the transaction.

In October 2003, the Company committed to an investment of $6.0 million in Petrosource Energy Company, LLC (Petrosource). The Company acquired 24.79% of the outstanding stock for a price of $3.6 million and advanced $2.4 million as a subordinated loan bearing 6% interest due in 6 years. $3.6 million of this commitment was paid in October 2003 and $2.4 million in February 2004. Petrosource is in the business of selling $CO_{(2)}$ and also owns pipelines and compressor stations for delivery purposes. The Company recorded a $0.1 million and $0.5 million net loss in 2003 and 2004 as a result of accounting for the Petrosource investment under the equity method.

In April 2002, the company entered into a revolving credit commitment to extend advances to an unrelated third party. Under the terms of the revolving credit arrangement, the Company agreed to make advances from time to time, as requested by the unrelated third party and subject to certain limitations, an amount up to $5 million. Advances made under the revolving credit commitment bear interest at prime rate plus 2% and are collateralized by inventory and receivables. As of December 31, 2004, the Company determined that a portion of the total outstanding advances of $1.3 million had been impaired and recorded a loss of $0.8 million. The loss is recorded as impairment of note receivable in the income statement.

NEG HOLDING LLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

6. Credit Facilities

On March 26, 2003, the Company distributed the $10.9 million note outstanding under the existing credit facility to NEG as a distribution of Priority Amount. Also, on March 26, 2003 NEG, Arnos and Operating LLC entered into an agreement to assign the existing credit facility to Operating LLC. Effective with this assignment, Arnos amended the credit facility to increase the revolving commitment to $150 million, increase the borrowing base to $75 million and extend the revolving due date until June 30, 2004. Concurrently, Arnos extended a $42.8 million loan to Operating LLC under the amended credit facility; Operating LLC then distributed $42.8 million to the Company who, thereafter, made a $40.5 million distribution of Priority Amount and a $2.3 million Guaranteed Payment to NEG. NEG utilized these funds to pay the entire amount of the long-term interest payable on the Senior Notes and interest accrued thereon outstanding on March 27, 2003. The Arnos facility was canceled on December 29, 2003 in conjunction with the Mizuho Corporate Bank, Ltd. financing.

On December 29, 2003, the Company entered into a Credit Agreement (the Credit Agreement) with certain commercial lending institutions, including Mizuho Corporate Bank, Ltd. as the Administrative Agent and the Bank of Texas, N.A. and the Bank of Nova Scotia as Co-Agents.

The Credit Agreement provides for a loan commitment amount of up to $120 million and a letter of credit commitment of up to $15 million (provided, the outstanding aggregate amount of the unpaid borrowings, plus the aggregate undrawn face amount of all outstanding letters of credit shall not exceed the borrowing base under the Credit Agreement). The Credit Agreement provides further that the amount available to the Company at any time is subject to certain restrictions, covenants, conditions and changes in the borrowing base calculation. In partial consideration of the loan commitment amount, the Company has pledged a continuing security interest in all of its oil and natural gas properties and its equipment, inventory, contracts, fixtures and proceeds related to its oil and natural gas business.

At the Company s option, interest on borrowings under the Credit Agreement bear interest at a rate based upon either the prime rate or the LIBOR rate plus, in each case, an applicable margin that, in the case of prime rate loans, can fluctuate from 0.75%to 1.50% per annum, and, in the case of LIBOR rate loans, can fluctuate from 1.75% to 2.50% per annum. Fluctuations in the applicable interest rate margins are based upon Operating LLC s total usage of the amount of credit available under the Credit Agreement, with the applicable margins increasing as the Company s total usage of the amount of the credit available under the Credit Agreement increases. The Credit Agreement expires on September 1, 2006.

At the closing of the Credit Agreement, the Company borrowed $43.8 million to repay $42.9 million owed by the Company to Arnos under the secured loan arrangement which was then terminated and to pay administrative fees in connection with this borrowing. The Company intends to use any future borrowings under the Credit Agreement to finance potential acquisitions. The Company has capitalized $1.4 million of loan issuance costs in connection with the closing of this transaction. These costs will be amortized over the life of the loan using the interest method.

As a condition to the lenders obligations under the Credit Agreement, the lenders required that the NEG, Gascon, Operating LLC and the Company execute and deliver at the closing that certain Pledge Agreement and Irrevocable Proxy in favor of Bank of Texas, N.A., its successors and assigns, the (Pledge Agreement). Pursuant to the terms of the Pledge Agreement, in order to secure the performance of the obligations of the Company (i) each of NEG and Gascon have pledged their 50% membership interest in the Company (such interests constituting 100% of the outstanding equity membership interest of the Company); (ii) the Company has pledged its 100% equity membership interest in Operating LLC; and (iii) Operating LLC has pledged its 100% equity membership interest in its subsidiary, Shana National LLC (the membership interests referred to in clauses (i), (ii) and (iii) above are collectively referred to as the Collateral). The Pledge Agreement also provides for a continuing security interest in the Collateral and that Bank of Texas, N.A. as the Collateral

NEG HOLDING LLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Agent is the duly appointed attorney-in-fact of the Company. The Collateral Agent may take all action deemed reasonably necessary for the maintenance, preservation and protection of the Collateral and the security interest therein until such time that all of the Company s obligations under the Credit Agreement are fulfilled, terminated or otherwise expired. If under the Credit Agreement an event of default shall have occurred and is continuing, the Collateral Agent may enforce certain rights and remedies, including, but not limited to the sale of the Collateral, the transfer of all or part of the Collateral to the Collateral Agent or its nominee and/or the execution of all endorsements.

Draws made under the credit facility are normally made to fund working capital requirements, acquisitions and capital expenditures. During the current fiscal year, the Company s outstanding balances thereunder have ranged from a low of $44 million to a high of $52 million. As of December 31, 2004 the outstanding balance under the credit facility was $52 million.

The Credit Agreement requires, among other things, semiannual engineering reports covering oil and natural gas properties, and maintenance of certain financial ratios, including the maintenance of a minimum interest coverage, a current ratio, and a minimum tangible net worth. The Company was in compliance with all covenants at December 31, 2003. Operating LLC was not in compliance with the minimum interest coverage ratio covenant at December 31, 2004. Operating LLC obtained a waiver of compliance with respect to this covenant for the period ended December 31, 2004. Operating LLC was in compliance with all other covenants at December 31, 2004.

7. Commitments and Contingencies

The Company has entered into a management agreement with NEG to manage Operating LLC s oil and natural gas assets until the earlier of November 1, 2006, or such time as Operating LLC no longer owns any oil and natural gas assets.

The Company is obligated to make semi-annual payments to NEG Guaranteed Payments as defined in the Holding LLC Operating Agreement referred herein. Two payments totaling $16.0 million were made in 2004, three payments totaling $18.2 million were made in 2003 and two payments totaling $21.7 million were made in 2002 under this obligation. In March 2003, the Company made a distribution of Priority Amount of $51.4 million to NEG.

On July 7, 2003, NEG filed a request with the American Arbitration Association for dispute resolution of a claim in the amount of $21,000 against Osprey Petroleum Company, Inc. (Osprey) arising out of Osprey s failure to post bond for certain plugging and abandonment liabilities associated with oil and gas properties sold by the Company to Osprey in September 2000. Osprey has counterclaimed against the NEG and its affiliates (Holding LLC and Operating LLC) in an amount up to $15 million, alleging fraud and breach of contract related to the sale of such oil and gas properties. The Purchase and Sale Agreement transferring the properties from the Company to Osprey provides for dispute resolution through binding arbitration utilizing arbitrator(s) experienced in oil and gas transactions. The exclusive venue for any such arbitration is in Dallas, Texas, and the binding, nonappealable judgment by the arbitrator(s) may be entered in any court having competent jurisdiction.

On February 24, 2005, the American Arbitration Association issued a ruling in favor of NEG on all issues. The Company was awarded the following:

(a) $20,500 in post bond premiums alleged to be owed for certain plugging and abandonment liabilities associated with the oil and gas properties sold to Osprey,

(b) $5,422 in expenses associated with NEG s bond claim,

(c) $53,226 in attorneys fees,

NEG HOLDING LLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(d) $24,617 in administrative expenses paid to the American Arbitration Association,

(e) an order requiring Osprey to post and maintain an acceptable replacement bond,

(f) a finding that Osprey s counterclaim in the amount of $15 million was without merit, and

(g) a ruling that Osprey is entitled to no recovery of any damages or expenses associated with NEG s bond claim or Osprey s counterclaim.

NEG intends to pursue the judgement awarded by the American Arbitration Association. Whether or not NEG recovers 100% of the award will have no material adverse effect on NEG s or the Company s financial condition or results of operations.

With respect to certain claims of the Company against Enron North America Corp. relating to the oil and natural gas properties contributed to Holding LLC, a representative of the Company has been appointed to the official committee of unsecured creditors in the Enron bankruptcy proceeding, and the Company has filed a claim for damages in that bankruptcy proceeding. The Company estimates its claim against Enron related to these contracts is approximately $7.25 million. The $7.25 million claim represents a hedge against future oil and natural gas prices and does not reflect a cash gain or loss. Any recoveries from Enron North America Corp. will become the property of Operating LLC as a result of the LLC Contribution. No receivable has been recorded as a result of this claim.

Other than routine litigation incidental to its business operations which are not deemed by the Company to be material, there are no additional legal proceedings in which the Company nor Operating LLC, is a defendant.

8. Asset Retirement Obligation

In June 2001, the Financial Accounting Standards Board (FASB) issued Statements of Financial Accounting Standards (SFAS) No. 143, *Accounting for Asset Retirement Obligations* (SFAS 143). The Company adopted SFAS 143 on January 1, 2003 and recorded an abandonment obligation of $3.0 million. SFAS No. 143 required the Company to record the fair value of an asset retirement obligation as a liability in the period in which it incurs a legal obligation associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development, and/or normal use of the assets. It also requires the Company to record a corresponding asset that is depreciated over the life of the asset. Subsequent to the initial measurement of the asset retirement obligation, the obligation will be adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The Company would have recorded accretion of the asset abandonment obligation of $0.2 million for both 2001 and 2002 had SFAS 143 been adopted in these years.

NEG HOLDING LLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following is a rollforward of the abandonment obligation as of December 31, 2003 and 2004.

Balance as of January 1, 2003		$	3,034,395
Add:	Accretion		242,752
	Additions		89,548
	Revisions		9,396
Less:	Settlements		(57,008)
	Dispositions		(50,702)
Balance as of December 31, 2003		$	3,268,381
Add:	Accretion		261,471
	Additions		93,838
Less:	Revisions		(250,650)
	Settlements		(24,354)
	Dispositions		(293,446)
Balance as of December 31, 2004		$	3,055,240

9. Distributions under the Holding LLC Operating Agreement

Under the Holding LLC Operating Agreement, NEG is to receive both Guaranteed Payments and the Priority Amount of $202.2 million before Gascon receives any monies. The distribution of Priority Amount is to be made on or before November 1, 2006. Guaranteed Payments are to be paid, on a semi annual basis, based on an annual interest rate of 10.75% of the outstanding Priority Amount. After the payments to NEG, Gascon is to receive distributions equivalent to the Priority Amount and Guaranteed Payments plus other amounts as defined. Following the above distributions to NEG and Gascon, additional distributions, if any, are to be made in accordance with their respective capital accounts. The order of distributions is listed below.

The Holding LLC Operating Agreement requires that distributions shall be made to both NEG and Gascon as follows:

1. Guaranteed Payments are to be paid to NEG, calculated on an annual interest rate of 10.75% on the outstanding Priority Amount. The Priority Amount includes all outstanding debt owed to entities owned or controlled by Carl C. Icahn, including the amount of the Company s 10.75% Senior Notes. As of December 31, 2004, the Priority Amount was $148.6 million. The Guaranteed Payments will be made on a semi-annual basis.

2. The Priority Amount is to be paid to NEG. Such payment is to occur by November 6, 2006.

3. An amount equal to the Priority Amount and all Guaranteed Payments paid to NEG, plus any additional capital contributions made by Gascon, less any distribution previously made by the Company to Gascon, is to be paid to Gascon.

4. An amount equal to the aggregate annual interest (calculated at prime plus 1/2% on the sum of the Guaranteed Payments), plus any unpaid interest for prior years (calculated at prime plus 1/2% on the sum of the Guaranteed Payments), less any distributions previously made by the Company to Gascon, is to be paid to Gascon.

5. After the above distributions have been made, any additional distributions will be made in accordance with the ratio of the NEG s and Gascon s respective capital accounts. (Capital accounts as defined in the Holding LLC

Operating Agreement).

NEG HOLDING LLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

10. Crude Oil and Natural Gas Producing Activities

Costs incurred in connection with the exploration acquisition, development, and exploitation of the Company s crude oil and natural gas properties for the years ended December 31, 2004, 2003 and 2002, (all of which occurred after the contribution of assets by NEG and Gascon) are as follows:

	Year Ended December 31,		
	2004	2003	2002
Acquisition of properties	$	$	$ 49,049,174
Exploration costs	29,006,772	6,950,706	1,072,997
Development costs	38,480,640	29,083,572	16,124,610
Depletion rate per Mcfe	$ 1.28	$ 1.25	$ 1.29

Revenues from individual purchasers that exceed 10% of total crude oil and natural gas sales are as follows:

	Year Ended December 31,		
	2004	2003	2002
Plains Marketing and Transportation	$ 19,786,979	$ 15,666,690	$ 12,512,767
Crosstex Energy Services, Inc.	5,080,974	9,225,086	4,843,756
Riata Energy, Inc.	29,884,850	30,420,624	
Seminole Energy Services	19,572,461	7,215,735	

11. Supplementary Crude Oil and Natural Gas Reserve Information (Unaudited)

The revenues generated by the Company s operations are highly dependent upon the prices of, and demand for, oil and natural gas. The price received by the Company for its oil and natural gas production depends on numerous factors beyond the Company s control, including seasonality, the condition of the U.S. economy, foreign imports, political conditions in other oil and natural gas producing countries, the actions of the Organization of Petroleum Exporting Countries and domestic governmental regulations, legislation and policies.

The Company has made ordinary course capital expenditures for the development and exploitation of oil and natural gas reserves, subject to economic conditions. The Company has interests in crude oil and natural gas properties that are principally located onshore in Texas, Louisiana, Oklahoma, and Arkansas. The Company does not own or lease any crude oil and natural gas properties outside the United States.

In 2004 and 2003, estimates of the Company s reserves and future net revenues were prepared by Netherland, Sewell & Associates, Prator Bett, LLC and DeGolyer and MacNaughton. In 2002, estimates of the Company s net recoverable crude oil, natural gas, and natural gas liquid reserves were prepared by Netherland, Sewell & Associates, Inc. and Prator Bett, LLC. Estimated proved net recoverable reserves as shown below include only those quantities that can be expected to be recoverable at prices and costs in effect at the balance sheet dates under existing regulatory practices and with conventional equipment and operating methods.

Proved developed reserves represent only those reserves expected to be recovered through existing wells. Proved undeveloped reserves include those reserves expected to be recovered from new wells on undrilled acreage or from existing wells on which a relatively major expenditure is required for recompletion.

NEG HOLDING LLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Net quantities of proved developed and undeveloped reserves of natural gas and crude oil, including condensate and natural gas liquids, are summarized as follows:

	Crude Oil (Barrels)	Natural Gas (Thousand Cubic Feet)
December 31, 2001	5,158,883	82,431,275
Purchases of reserves in place	30,436	34,196,450
Sales of reserves in place	(223,214)	
Extensions and discoveries	28,892	14,403,643
Revisions of previous estimates	842,776	(636,931)
Production	(629,100)	(7,827,100)
December 31, 2002	5,208,673	122,567,337
Purchase of reserves in place		
Sales of reserves in place	(25,399)	(744,036)
Extensions and discoveries	494,191	61,637,828
Revisions of previous estimates	(7,092)	(2,419,969)
Production	(628,923)	(13,436,865)
December 31, 2003	5,041,450	167,604,295
Purchase of reserves in place		
Sales of reserves in place	(15,643)	(344,271)
Extensions and discoveries	445,636	33,350,666
Revisions of previous estimates	(30,249)	15,441,298
Production	(565,100)	(13,106,103)
December 31, 2004	4,876,094	202,945,885
Proved developed reserves:		
December 31, 2002	3,539,450	92,382,411
December 31, 2003	4,096,596	104,207,660
December 31, 2004	3,798,341	111,126,829

Reservoir engineering is a subjective process of estimating the volumes of underground accumulations of oil and natural gas which cannot be measured precisely. The accuracy of any reserve estimates is a function of the quality of available data and of engineering and geological interpretation and judgment. Reserve estimates prepared by other engineers might differ from the estimates contained herein. Results of drilling, testing, and production subsequent to the date of the estimate may justify revision of such estimate. Future prices received for the sale of oil and natural gas may be different from those used in preparing these reports. The amounts and timing of future operating and development costs may also differ from those used. Accordingly, reserve estimates are often different from the quantities of oil and natural gas that are ultimately recovered.

The following is a summary of a standardized measure of discounted net cash flows related to the Company s proved crude oil and natural gas reserves. For these calculations, estimated future cash flows from estimated future production of proved reserves were computed using crude oil and natural gas prices as of the end of each period presented. Future development, production and net asset retirement obligations attributable to the proved reserves were estimated assuming that existing conditions would continue over the economic lives of the individual leases and costs were not escalated for the future.

NEG HOLDING LLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company cautions against using the following data to determine the fair value of its crude oil and natural gas properties. To obtain the best estimate of fair value of the crude oil and natural gas properties, forecasts of future economic conditions, varying discount rates, and consideration of other than proved reserves would have to be incorporated into the calculation. In addition, there are significant uncertainties inherent in estimating quantities of proved reserves and in projecting rates of production that impair the usefulness of the data.

The standardized measure of discounted future net cash flows relating to proved crude oil and natural gas reserves are summarized as follows:

	December 31,	
	2004	2003
Future cash inflows	$ 1,466,369,163	$ 1,184,869,747
Future production and development costs	(489,331,736)	(374,829,047)
Future net cash flows	977,037,427	810,040,700
10% annual discount for estimated timing of cash flows	(442,213,801)	(353,980,596)
Standardized measure of discounted future net cash flows	$ 534,823,626	$ 456,060,104

The following are the principal sources of change in the standardized measure of discounted future net cash flows:

	Year Ended December 31,		
	2004	2003	2002
Purchases of reserves	$	$	$ 102,916,472
Sales of reserves in place	(1,375,463)	(2,475,742)	(2,509,704)
Sales and transfers of crude oil and natural gas produced, net of production costs	(83,004,073)	(57,424,780)	(31,115,247)
Net changes in prices and production costs	31,039,998	44,711,900	112,380,701
Development costs incurred during the period and changes in estimated future development costs	(81,370,910)	(75,286,532)	(45,230,813)
Extensions and discoveries, less related costs	118,570,850	211,324,414	43,640,702
Revisions of previous quantity estimates	49,194,080	(6,789,000)	8,510,824
Accretion of discount	45,606,010	31,063,232	11,312,180
Changes in production rates (timing) and other	103,030	304,290	(2,394,593)
Net change	$ 78,763,522	$ 145,427,782	$ 197,510,522

During recent years, there have been significant fluctuations in the prices paid for crude oil in the world markets. This situation has had a destabilizing effect on crude oil posted prices in the United States, including the posted prices paid by purchasers of the Company s crude oil. The net weighted average prices of crude oil and natural gas at December 31, 2004, 2003 and 2002 used in the above table were $42.10, $31.14 and $29.86 per barrel of crude oil, respectively, and $5.92, $5.87 and $4.92 per thousand cubic feet of natural gas, respectively.

NEG HOLDING LLC
CONSOLIDATED BALANCE SHEET

		March 31, 2005
		(Unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	$	10,999,200
Accounts receivable oil and natural gas sales		17,388,724
Accounts receivable joint interest and other		216,496
Notes receivable other, (net allowance of $790,000)		488,415
Drilling prepayments		793,558
Other		1,104,408
Total current assets		30,990,801
Oil and natural gas properties, at cost (full cost method):		
Subject to ceiling limitation		594,136,210
Accumulated depreciation, depletion, and amortization		(349,909,614)
Net oil and natural gas properties		244,226,596
Other property and equipment		5,143,947
Accumulated depreciation		(4,154,948)
Net other property and equipment		988,999
Note receivable		3,090,000
Equity investment		2,169,566
Other long term assets		962,696
Total assets	$	282,428,658
Current liabilities:		
Accounts payable trade	$	6,423,198
Accounts payable affiliate		369,722
Accounts payable revenue		4,158,627
Prepayments from partners		87,754
Other current liabilities		806,885
Derivative financial instruments		23,852,452
Total current liabilities		35,698,638
Long term liabilities:		
Gas balancing		897,853
Credit facility		66,833,624
Asset retirement obligation		3,116,344
Derivative financial instruments		12,883,768
Members equity		162,998,431

Total liabilities and members equity	$	282,428,658

See accompanying notes.

NEG HOLDING LLC
CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended March 31,	
	2005	**2004**
	(Unaudited)	
Revenues:		
Oil and natural gas sales	$ 2,346,633	$ 25,017,234
Field operations	80,630	79,161
Plant operations	442,609	472,786
Total revenue	2,869,872	25,569,181
Costs and expenses:		
Lease operating	3,883,238	3,126,587
Field operations	78,371	90,494
Plant operations	174,442	125,548
Oil and natural gas production taxes	1,695,128	1,349,374
Depreciation, depletion and amortization	6,515,506	5,352,006
Accretion of asset retirement obligation	61,104	63,807
General and administrative	556,457	824,295
Total costs and expenses	12,964,246	10,932,111
Operating income (loss)	(10,094,374)	14,637,070
Other income (expense):		
Interest expense	(728,809)	(483,166)
Amortization of debt issuance costs	(172,890)	(111,809)
Interest income and other, net	22,639	89,249
Interest income from affiliate		35,803
Interest in loss of equity investee	(209,542)	
Net income (loss)	$ (11,182,976)	$ 14,167,147

See accompanying notes.

NEG HOLDING LLC
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended March 31,	
	2005	2004
	(Unaudited)	
Operating Activities		
Net income (loss)	$ (11,182,976)	$ 14,167,147
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation, depletion and amortization	6,515,506	5,352,006
Change in fair market value of derivative contracts	22,620,363	(2,688,548)
Amortization of debt issuance costs	172,890	111,809
Interest in loss of equity investee	209,543	
Accretion of asset retirement obligation	61,104	63,807
Changes in operating assets and liabilities:		
Accounts receivable	1,111,132	(1,064,720)
Notes receivable		(1,207,198)
Drilling prepayments	64,556	254,227
Derivative broker deposit		1,700,000
Other current assets	1,095,752	(20,439)
Accounts payable and accrued liabilities	(4,343,276)	1,626,714
Net cash provided by operating activities	16,324,594	18,294,805
Investing Activities		
Oil and natural gas exploration and development expenditures	(21,189,663)	(10,869,942)
Purchases of other property and equipment	(88,457)	(38,467)
Proceeds from sales of oil and natural gas properties	122,967	
Equity investment		(1,200,000)
Net cash used in investing activities	(21,155,153)	(12,108,409)
Financing Activities		
Proceeds from Mizuho credit facility	15,000,000	
Proceeds from advance from affiliate	5,000,000	
Repayment of advance from affiliate	(5,000,000)	
Loan issuance costs	(53,082)	(328,599)
Net cash (used in) provided by financing activities	14,946,918	(328,599)
Increase in cash and cash equivalents	10,116,359	5,857,797
Cash and cash equivalents at beginning of period	882,841	15,401,433
Cash and cash equivalents at end of period	$ 10,999,200	$ 21,259,230

Supplemental Cash Flow Information		
Interest paid in cash	$ 247,022	$ 148,979

See accompanying notes.

NEG HOLDING LLC
CONSOLIDATED STATEMENT OF MEMBERS EQUITY

		Members Equity (Unaudited)
Balance at December 31, 2004	$	174,181,407
Net loss for the three months ended March 31, 2005		(11,182,976)
Balance at March 31, 2005	$	162,998,431

See accompanying notes.

NEG HOLDING LLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the Three Months and Period Ended March 31, 2005 and 2004 (Unaudited)

1. Background

NEG Holding LLC (the Company), a Delaware limited liability company, was formed in August 2000. The initial formation was part of a plan of reorganization under Chapter 11 of the US bankruptcy code by National Energy Group, Inc. (NEG). Under the terms of the bankruptcy plan and the various formation agreements, NEG contributed essentially all of its operating assets and Gascon Partners (Gascon) contributed a note receivable from NEG and its 100% ownership interest in an oil and natural gas producing company to the Company s wholly-owned subsidiary, NEG Operating, LLC (Operating LLC). In exchange, each party received a 50% membership interest in the Company. Both NEG and Gascon Partners are affiliates by virtue of their majority common ownership by Carl C. Icahn. The initial formation of the Company was effective May, 2001 and, because of the common majority ownership of the members, all contributions were initially recorded at historical book values of the contributed net assets as of September 1, 2001.

Under Delaware law and the terms of the initial formation agreements, the Company may be dissolved and its affairs wound up at any time based on the sole discretion the managing member, Gascon, and in no event later than December 31, 2024. The Company has prepared its financial statements on a going concern basis which assumes the Company will continue to operate into the foreseeable future.

Essentially all of the Company s operations are contained in Operating, LLC. The day-to-day operations of Operating LLC are managed by NEG and the strategic direction is determined by the managing member, currently Gascon. The Company pays a monthly management fee to NEG that is based on an agreed formula that is approximately equal to direct and indirect costs and reasonable overhead cost incurred, plus 15%. The management agreement with NEG expires on December 1, 2006 or such time as Operation LLC no longer owns any oil and natural gas assets.

2. Basis of Presentation

The accompanying unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and Article 10 of Regulation S-X and are fairly presented. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, these financial statements contain all adjustments, consisting of normal recurring accruals, necessary to present fairly the financial position, results of operations and cash flows for the periods indicated. The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from these estimates. The Company s interim financial data should be read in conjunction with the financial statements of the Company for the year ended December 31, 2004 (including the notes thereto).

The results of operations for the three month periods ended March 31, 2005, and 2004 are not necessarily indicative of the results expected for the full year.

3. Recent Accounting Pronouncements

On December 16, 2004, the FASB issued SFAS 123 (revised 2004), *Share-Based Payment* , which will require compensation costs related to share-based payment transactions (e.g., issuance of stock options and restricted stock) to be recognized in the financial statements. With limited exceptions, the amount of compensation cost will be measured based on the grant-date fair value of the equity or liability instruments issued. In addition, liability awards will be remeasured each reporting period. Compensation cost will be recognized over the period that an employee provides service in exchange for the award. SFAS 123(R) revises SFAS 123, *Accounting for Stock-Based Compensation,* and supersedes Accounting Principles Board

NEG HOLDING LLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(APB) Opinion No. 25, *Accounting for Stock Issued to Employees.* For the Company, SFAS 123(R), as amended by SEC Release 34-51558, is effective for the first fiscal year beginning after June 15, 2004 (January 1, 2006). Entities that use the fair-value-based method for either recognition or disclosure under SFAS 123 are required to apply SFAS 123(R) using a modified version of prospective application. Under this method, an entity records compensation expense for all awards it grants after the date of adoption. In addition, the entity is required to record compensation expense for the unvested portion of previously granted awards that remain outstanding at the date of adoption. In addition, entities may elect to adopt SFAS 123(R) using a modified retrospective method where by previously issued financial statements are restated based on the expense previously calculated and reported in their pro forma footnote disclosures. The Company had no share based payments subject to this standard.

On December 16, 2004, the FASB issued SFAS 153, *Exchanges of Nonmonetary Assets,* an amendment of APB Opinion No. 29, to clarify the accounting for nonmonetary exchanges of similar productive assets. SFAS 153 provides a general exception from fair value measurement for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS 153 will be applied prospectively and is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The Company did not have any nonmonetary transactions for any period presented that this Statement would apply.

On March 30, 2005, FASB issued FASB Interpretation No. (FIN) 47, Accounting for Conditional Asset Retirement Obligations. FIN 47 clarifies that the term conditional asset retirement obligation as used in SFAS 143, Accounting for Asset Retirement Obligations, refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Uncertainty about the timing and or method of settlement of a conditional asset retirement obligation should be factored into the measurement of the liability when sufficient information exists. FIN 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. FIN 47 is effective no later than the end of fiscal years ending after December 15, 2005 (December 31, 2005 for calendar year-end companies). Retrospective application of interim financial information is permitted but not required and early adoption is encouraged. The adoption of FIN 47 will have no material impact on the Company s financial statements.

4. Derivatives

Substantially all of the Company s revenues are derived from crude oil and natural gas sales. The Company periodically manages its exposure to fluctuations in crude oil and natural gas prices by entering into various derivative instruments with high credit quality counter-parties. The Company s derivative instruments consist principally of collar options and swaps. The Company does not designate any derivative instruments as hedges and, accordingly, all derivatives are marked-to-market at the end of each reporting period and any gains or losses are recognized in income as an increase or decrease in oil and gas sales. During the three month period ended March 31, 2004, the Company recorded an unrealized gain of $2,688,548 and the Company recorded an unrealized loss of $22,620,363 for the three months ended March 31, 2005 on its derivatives contracts.

The Company is required to provide collateral to its counter party for its derivative positions in the form of a margin deposit. During 2004, the Company negotiated a new credit agreement (see Note 7) and replaced the cash deposits with a letter of credit from the financial institution. At March 31, 2005 the letter(s) of credit that secured the Company s derivative positions aggregated $11.0 million.

NEG HOLDING LLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Upon maturity, the Company is required to cash settle each derivative contract. During the three month periods ended March 31, 2004 and 2005, the Company made $0.5 million and $2.6 million, respectively, in net cash payments in settlement of maturing derivatives contracts. As of March 31, 2005, the Company has a liability of $36,736,220 representing the approximate market value obligation of its derivatives contracts, of which $23,852,452 is current.

5. Management Fees

During the three months ended March 31, 2004 and 2005, the Company paid management fees to NEG aggregating $1.5 million and $1.1 million, respectively which is included in general and administrative expenses and lease operating expenses.

6. Investment in Petrosource

In October 2003, the Company committed to an investment of $6.0 million in Petrosource Energy Company, LLC (Petrosource). The Company acquired 24.79% of the outstanding stock for a price of $3.6 million and advanced $2.4 million as a subordinated loan bearing 6% interest due in 6 years. $3.6 million of this commitment was paid in October 2003 and $2.4 million in February 2004. Petrosource is in the business of selling CO2 and also owns pipelines and compressor stations for delivery purposes. The Company accounts for its investment in Petrosource under the equity method and recorded a $209,543 net loss for the three month period ended March 31, 2005.

7. Credit Facilities

On December 29, 2003, the Company entered into a Credit Agreement (the Credit Agreement) with certain commercial lending institutions, including Mizuho Corporate Bank, Ltd. as the Administrative Agent and the Bank of Texas, N.A. and the Bank of Nova Scotia as Co-Agents.

The Credit Agreement provides for a loan commitment amount of up to $120 million and a letter of credit commitment of up to $15 million (provided, the outstanding aggregate amount of the unpaid borrowings, plus the aggregate undrawn face amount of all outstanding letters of credit shall not exceed the borrowing base under the Credit Agreement). The Credit Agreement provides further that the amount available to the Company at any time is subject to certain restrictions, covenants, conditions and changes in the borrowing base calculation. In partial consideration of the loan commitment amount, the Company has pledged a continuing security interest in all of its oil and natural gas properties and its equipment, inventory, contracts, fixtures and proceeds related to its oil and natural gas business.

At the Company s option, interest on borrowings under the Credit Agreement bear interest at a rate based upon either the prime rate or the LIBOR rate plus, in each case, an applicable margin that, in the case of prime rate loans, can fluctuate from 0.75% to 1.50% per annum, and, in the case of LIBOR rate loans, can fluctuate from 1.75% to 2.50% per annum. Fluctuations in the applicable interest rate margins are based upon Operating LLC s total usage of the amount of credit available under the Credit Agreement, with the applicable margins increasing as the Company s total usage of the amount of the credit available under the Credit Agreement increases. The Credit Agreement expires on September 1, 2006.

At the closing of the Credit Agreement (December, 2003), the Company borrowed $43.8 million to repay $42.9 million owed by the Company to a related party under the secured loan arrangement which was then terminated and to pay administrative fees in connection with this borrowing. The Company intends to use any future borrowings under the Credit Agreement to finance potential acquisitions. The Company capitalized $1.4 million of loan issuance costs in connection with the closing of this transaction. These costs are amortized over the life of the loan using the interest method. $111,809 and $172,890 were amortized during the three months ended March 31, 2004 and 2005 and are included as debt issuance costs in the income statement.

NEG HOLDING LLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

As a condition to the lenders obligations under the Credit Agreement, the lenders required that the NEG, Gascon, Holding LLC and the Company execute and deliver at the closing that certain Pledge Agreement and Irrevocable Proxy in favor of Bank of Texas, N.A., its successors and assigns, the (Pledge Agreement). Pursuant to the terms of the Pledge Agreement, in order to secure the performance of the obligations of the Company (I) each of NEG and Gascon have pledged their 50% membership interest in Holding LLC (such interests constituting 100% of the outstanding equity membership interest of Holding LLC); (ii) Holding LLC has pledged its 100% equity membership interest in the Company; and (iii) the Company has pledged its 100% equity membership interest in its subsidiary, Shana National LLC (the membership interests referred to in clauses (I), (ii) and (iii) above are collectively referred to as the Collateral). The Pledge Agreement also provides for a continuing security interest in the Collateral and that Bank of Texas, N.A. as the Collateral Agent is the duly appointed attorney-in-fact of the Company. The Collateral Agent may take all action deemed reasonably necessary for the maintenance, preservation and protection of the Collateral and the security interest therein until such time that all of the Company s obligations under the Credit Agreement are fulfilled, terminated or otherwise expired. If under the Credit Agreement an event of default shall have occurred and is continuing, the Collateral Agent may enforce certain rights and remedies, including, but not limited to the sale of the Collateral, the transfer of all or part of the Collateral to the Collateral Agent or its nominee and/or the execution of all endorsements.

The Credit Agreement requires, among other things, semiannual engineering reports covering oil and natural gas properties, and maintenance of certain financial ratios, including the maintenance of a minimum interest coverage, a current ratio, and a minimum tangible net worth. The Company was in compliance with all covenants at March 31, 2005.

8. Note Receivable

At the request of the Company s controlling member, in April 2002, the Company entered into a revolving credit commitment to extend advances to an unrelated third party. The unrelated third party has no business relationship with the Company s controlling member. Under the terms of the revolving credit arrangement, the Company agreed to make advances from time to time, as requested by the unrelated third party and subject to certain limitations, an amount up to $5 million. Advances made under the revolving credit commitment bear interest at prime rate plus 2% and is collateralized by inventory and receivables. During 2004, the Company determined that a portion of the total outstanding advances of $1,253,154 had been impaired and established a $790,000 allowance to offset the note.

9. Commitments and Contingencies

The Company has entered into a management agreement with NEG to manage Operating LLC s oil and natural gas assets until the earlier of November 1, 2006, or such time as Operating LLC no longer owns any oil and natural gas assets.

Under the terms of the Company s formation agreements, the Company is obligated to make semi-annual payments Guaranteed Payments and periodic Priority Amount distributions to NEG. No Guaranteed Payments were made during the months ended March 31, 2004 and 2005.

On July 7, 2003, the Company filed a request with the American Arbitration Association for dispute resolution of a claim in the amount of $21,000 against Osprey Petroleum Company, Inc. (Osprey) arising out of Osprey s failure to post bond for certain plugging and abandonment liabilities associated with oil and gas properties sold by the Company to Osprey in September 2000. Osprey has counterclaimed against the Company and its affiliates (Holding LLC and Operating LLC) in an amount up to $15 million, alleging fraud and breach of contract related to the sale of such oil and gas properties. The Purchase and Sale Agreement transferring the properties from the Company to Osprey provides for dispute resolution through binding arbitration utilizing arbitrator(s) experienced in oil and gas transactions. The exclusive venue for any such

NEG HOLDING LLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

arbitration is in Dallas, Texas, and the binding, nonappealable judgment by the arbitrator(s) may be entered in any court having competent jurisdiction.

On February 24, 2005, the American Arbitration Association issued a ruling in favor of the Company on all issues. The Company was awarded the following:

(a) $20,500 in post bond premiums alleged to be owed for certain plugging and abandonment liabilities associated with the oil and gas properties sold to Osprey,

(b) $5,422 in expenses associated with our bond claim,

(c) $53,226 in attorneys fees,

(d) $24,617 in administrative expenses paid to the American Arbitration Association,

(e) an order requiring Osprey to post and maintain an acceptable replacement bond,

(f) a finding that Osprey s counterclaim in the amount of $15 million was without merit, and

(g) a ruling that Osprey is entitled to no recovery of any damages or expenses associated with the Company s bond claim or Osprey s counterclaim.

With respect to certain claims of the Company against Enron North America Corp. relating to the oil and natural gas properties contributed to Holding LLC, a representative of the Company has been appointed to the official committee of unsecured creditors in the Enron bankruptcy proceeding, and the Company has filed a claim for damages in that bankruptcy proceeding. This claim represents a hedge against future oil and natural gas prices and does not reflect a cash gain or loss. Any recoveries from Enron North America Corp. will become the property of Operating LLC as a result of the LLC Contribution.

Other than routine litigation incidental to its business operations which are not deemed by the Company to be material, there are no additional legal proceedings in which the Company nor Operating LLC, is a defendant.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors
Panaco, Inc.

We have audited the accompanying balance sheets of Panaco, Inc. (the Company or Panaco) as of December 31, 2004 and 2003 and the related statements of operations, stockholders equity and cash flows for each of the three years in the period ended December 31, 2004. 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 the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Panaco, Inc. as of December 31, 2004 and 2003, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2004, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 2 to the financial statements, effective January 1, 2003, the Company changed its method of accounting for asset retirement obligations.

/s/ Pannell Kerr Forster of Texas, P.C.

March 18, 2005

PANACO, INC.
BALANCE SHEETS

	December 31, 2004	December 31, 2003
ASSETS		
Current assets		
Cash	$ 23,753,000	$ 3,152,000
Restricted cash		8,716,000
Accounts receivable, net of allowance of $5,947,000 and $5,847,000 as of December 31, 2004 and December 31, 2003, respectively	8,641,000	8,233,000
Accounts receivable other	1,841,000	
Prepaid expenses and other current assets	4,652,000	1,001,000
Deferred taxes, net	1,943,000	
Total current assets	40,830,000	21,102,000
Property, plant and equipment		
Oil and natural gas properties, successful efforts method of accounting	326,733,000	323,001,000
Less accumulated depreciation, depletion and amortization	(263,140,000)	(246,803,000)
Oil and natural gas properties, net	63,593,000	76,198,000
Pipelines and other property, plant and equipment	26,114,000	26,303,000
Less accumulated depreciation	(17,789,000)	(16,023,000)
Pipelines and other property, plant and equipment, net	8,325,000	10,280,000
Other assets		
Restricted deposits	23,519,000	18,234,000
Deferred taxes, net	21,341,000	
Total assets	$ 157,608,000	$ 125,814,000
LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)		
Liabilities not subject to compromise		
Current liabilities		
Accounts payable and accrued liabilities	$ 13,517,000	$ 6,506,000
Accounts payable related party	555,000	
Interest payable related party	288,000	
Interest payable		220,000
Income tax payable	157,000	
Current maturities of long-term debt related party	5,429,000	
Revolving credit facility		35,272,000

Total current liabilities		19,946,000		41,998,000
Long-term debt related party, net of current maturities		32,571,000		
Deferred credits		263,000		556,000
Asset retirement obligation		49,538,000		43,933,000
Total liabilities not subject to compromise		102,318,000		86,487,000
Liabilities subject to compromise				
Accounts payable and accrued liabilities				19,838,000
Interest payable				3,115,000
Natural gas imbalance payable				1,311,000
Senior notes due 2004				100,000,000
Total liabilities subject to compromise				124,264,000
Commitments and contingencies				
Stockholders equity (deficit)				
Preferred shares, $0.01 par value, 5,000,000 shares authorized at December 31, 2003; no shares issued and outstanding at December 31, 2003 (see Note 1)				
New common shares, $0.01 par value, 1,000,000 shares authorized; 1,000 shares issued and outstanding as of December 31, 2004				
Old common shares, $0.01 par value, 100,000,000 shares authorized; 24,359,695 shares issued and outstanding as of December 31, 2003				247,000
Additional paid-in capital		121,140,000		69,089,000
Accumulated deficit		(65,850,000)		(154,273,000)
Total stockholders equity (deficit)		55,290,000		(84,937,000)
Total liabilities and stockholders deficit	$	157,608,000	$	125,814,000

See accompany notes to financial statements.

PANACO, INC.
STATEMENTS OF OPERATIONS

	Year Ended December 31,		
	2004	**2003**	**2002**
Oil and natural gas sales	$ 51,234,000	$ 50,160,000	$ 39,065,000
Costs and expenses:			
Lease operating expenses and ad valorem taxes	14,040,000	17,218,000	14,508,000
Production taxes	711,000	1,021,000	720,000
Geological and geophysical expenses	76,000	105,000	119,000
Depletion, depreciation and amortization	19,008,000	12,812,000	36,986,000
Impairment of oil and natural gas properties			23,291,000
General and administrative expenses	2,284,000	2,290,000	3,550,000
Management fees and other related party	884,000		
Bad debt expense	100,000	1,896,000	510,000
Accretion of asset retirement obligation	3,132,000	2,843,000	
Gain on expiration of production payment		(2,249,000)	
Total cost and expenses	40,235,000	35,936,000	79,684,000
Operating income (loss)	10,999,000	14,224,000	(40,619,000)
Other income (expense):			
Interest income	684,000	274,000	500,000
Other income	48,000		
Interest expense	(912,000)	(2,929,000)	(9,298,000)
Interest expense related party	(1,605,000)		
Loss on sale of assets	(76,000)		
Total other expense. net	(1,861,000)	(2,655,000)	(8,798,000)
Income (loss) before reorganization costs, income taxes and cumulative effect of accounting change	9,138,000	11,569,000	(49,417,000)
Reorganization costs:			
Deferred debt costs			(962,000)
Professional fees	(3,794,000)	(2,898,000)	(1,296,000)
Loss on restructuring of debt related party	(3,561,000)		
Gain on restructuring of senior notes due 2004	51,268,000		
Gain on restructuring of payables	12,495,000		
Income (loss) before cumulative effect of accounting change	65,546,000	8,671,000	(51,675,000)
Income tax benefit, net	22,877,000		
Cumulative effect of accounting change, net of tax		(12,149,000)	

Net income (loss)	$ 88,423,000	$ (3,478,000)	$ (51,675,000)
Basic and diluted earnings (loss) per share (see Note 2):			
Income (loss) before cumulative effect of accounting change		$ 0.36	$ (2.12)
Cumulative effect of accounting change, net of tax		(0.50)	
Net loss		$ (0.14)	$ (2.12)
Basic and diluted weighted average common shares outstanding		24,359,695	24,359,695

See accompanying notes to financial statements.

PANACO, INC.
STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY (DEFICIT)
Years Ended December 31, 2004, 2003 and 2002

	Number of New Common Shares	Number of Old Common Shares	Common Share Par Value	Additional Paid-In Capital	Accumulated Deficit	Total Stockholders Equity (Deficit)
Balance, December 31, 2001		24,359,695	$ 247,000	$ 69,089,000	$ (99,120,000)	$ (29,784,000)
Net loss					(51,675,000)	(51,675,000)
Balance, December 31, 2002		24,359,695	247,000	69,089,000	(150,795,000)	(81,459,000)
Net loss					(3,478,000)	(3,478,000)
Balance, December 31, 2003		24,359,695	247,000	69,089,000	(154,273,000)	(84,937,000)
Cancellation Old Common Stock		(24,359,695)	(247,000)	247,000		
Issuance of New Common Stock	1,000			51,804,000		51,804,000
Net income					88,423,000	88,423,000
Balance, December 31, 2004	1,000		$	$ 121,140,000	$ (65,850,000)	$ 55,290,000

PANACO, INC.
STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2004	**2003**	**2002**
Cash flows from operating activities			
Net income (loss)	$ 88,423,000	$ (3,478,000)	$ (51,675,000)
Adjustments to reconcile net income (loss) to net cash provided from operating activities			
Depletion, depreciation and amortization	19,008,000	12,812,000	36,986,000
Impairment of oil and natural gas properties			23,291,000
Deferred income taxes	(23,284,000)		
Loss on sale of assets	76,000		
Unrealized loss on derivative instruments	903,000		
Loss on restructuring of debt related party	3,561,000		
Gain on restructuring of senior notes due 2004	(51,268,000)		
Gain on restructuring of payables	(12,495,000)		
Allowance for doubtful accounts	100,000	1,896,000	510,000
Accretion of asset retirement obligation	3,132,000	2,843,000	
Deferred debt costs			962,000
Gain on expiration of production payment		(2,249,000)	
Cumulative effect of accounting change		12,149,000	
Changes in operating assets and liabilities			
Accounts receivable	(508,000)	(1,353,000)	(924,000)
Accounts receivable other	(1,841,000)		
Prepaid expenses and other current assets	(3,651,000)	20,000	(103,000)
Accounts payable and accrued liabilities	(3,278,000)	(5,306,000)	(3,560,000)
Accounts payable related party	555,000		
Natural gas imbalance payable	(1,311,000)	154,000	8,000
Deferred credits	(293,000)	(397,000)	(552,000)
Interest payable	1,385,000	(661,000)	1,132,000
Income taxes payable	157,000		
Net cash provided by operating activities	19,371,000	16,430,000	6,075,000
Cash flows from investing activities			
Capital expenditures	(1,994,000)	(3,875,000)	(6,494,000)
Proceeds from property sale	150,000		
Increase in restricted deposits	(5,285,000)	(4,907,000)	(2,316,000)
Asset retirement obligation	(207,000)	(1,028,000)	
Net cash used in investing activities	(7,336,000)	(9,810,000)	(8,810,000)
Cash flows from financing activities			
Proceeds from borrowings of debt			8,101,000
Repayment of debt	(150,000)	(2,450,000)	(3,250,000)

Net cash provided by (used in) financing activities		(150,000)		(2,450,000)		4,851,000
Net increase in cash		11,885,000		4,170,000		2,116,000
Decrease (increase) in restricted cash		8,716,000		(8,716,000)		
Cash at beginning of year		3,152,000		7,698,000		5,582,000
Cash at end of year	$	23,753,000	$	3,152,000	$	7,698,000
Supplemental Disclosure of Cash Flow Information:						
Interest paid	$	1,129,000	$	3,590,000	$	8,166,000
Income taxes paid	$	272,000	$		$	
Supplemental Non-cash Investing and Financing Activities:						
Oil and natural gas properties for asset retirement obligation	$	2,680,000	$	26,344,000	$	
Interest payable related party converted to debt principal	$	1,317,000	$		$	
Senior notes due 2004 and accrued interest converted to new common stock and additional paid-in capital	$	51,804,000	$		$	
Old common stock converted to additional paid-in capital	$	247,000	$		$	

See accompanying notes to financial statements.

PANACO, INC.
NOTES TO FINANCIAL STATEMENTS

Note 1 Voluntary Petition for Relief Under Chapter 11 Bankruptcy

On July 16, 2002, Panaco, Inc. (the Company or Panaco) filed a Voluntary Petition for Relief under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court of the Southern District of Texas. The filing was made primarily due to the Company s inability to pay its debts as they became due including the existence of a significant working capital deficit at December 31, 2001 and continuing through June 30, 2002. In addition, at the time of filing the voluntary petition for relief, the Company was not in compliance with certain financial and technical covenants of its $40 million revolving credit facility (the Credit Facility) and the indenture entered into in connection with its indebtedness of $100 million of Senior Notes due 2004, (the Senior Notes and the Senior Notes Indenture). The Company s forecasts of future results from operations indicated that the Company would not be able to reverse its working capital deficit, cure its covenant violations or provide capital required to develop its oil and natural gas reserves.

An order for relief was entered by the Bankruptcy Court, placing the Company under protection of the Bankruptcy Court, which precludes payment of the interest on the Senior Notes. In addition, payment of liabilities existing as of July 15, 2002 to certain unsecured creditors and pending litigation are stayed during the Bankruptcy proceeding. For the period from July 16, 2002 through November 15, 2004, the Company operated as a debtor-in-possession and continued to operate and manage its assets in the ordinary course of business during the Chapter 11 proceeding. On November 3, 2004, the Court entered a confirmation order for the Company s Plan of Reorganization (the Plan). The Plan became effective November 16, 2004 (Effective Date) and the Company began operating as a reorganized entity.

The Plan generally provided that the Company s liabilities, classified as Subject to Compromise on the accompanying balance sheets, be satisfied in full in exchange for the following:

Revolving Credit Facility: the holder of the claim received a new note, the principal amount of which will be paid over seven years,

Senior Notes: 49% of the Senior Notes were settled for a cash payment equal to 2.5% of the face value of the Senior Notes; 51% of the Senior Notes were converted into 100% of the equity of the reorganized Company,

Unsecured Creditors: received a cash payment equal to 10% of their allowed claim.

Equity: the pre-confirmation shares of common stock (the Old Common Stock) are deemed to be of no value and were cancelled. The equity of the reorganized Company became owned by the 51% Senior Note holders.

The Plan also further specified that the Company no longer has the authority to issue non-voting equity shares. As such, there are no authorized or issued preferred shares as of December 31, 2004.

For the period from July 16, 2002 through November 15, 2004, the financial statements have been prepared in accordance with Statement of Position 90-7, *Financial Reporting by Entities in Reorganization Under the Bankruptcy Code,* (SOP 90-7). In accordance with SOP 90-7, as of the petition date, the Company discontinued accruing interest and amortization of deferred debt costs related to liabilities subject to compromise.

As a result of the Plan, a gain was recognized on the restructuring in accordance with Statement of Financial Accounting Standards No. 15 (SFAS No. 15), *Accounting by Debtors and Creditors for Troubled Debt Restructurings.* The total gain on restructuring was approximately $63.8 million which is comprised of the forgiveness of $51.3 million of unsecured Senior Notes and $12.5 million of payables owed to unsecured creditors. Furthermore, approximately $51.8 million of unsecured Senior Notes and the corre-

PANACO, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)

sponding accrued interest were exchanged for 100% of the new common stock (1,000 shares) (the New Common Stock) of the reorganized Company.

Due to the lack of change in control of the Company post bankruptcy, the reorganization of the Company was accounted for as a recapitalization and debt restructuring.

Note 2 Summary of Significant Accounting Policies

Nature of business

The Company is an independent oil and natural gas exploration and production company with operations focused in the Gulf of Mexico and onshore in the Gulf Coast region. The Company operates a majority of its oil and natural gas producing assets in order to control the operations and the timing of expenditures. The majority of the Company s properties are located in state or federal waters in the Gulf of Mexico, where the costs of operations, productions rates and reserve potential are generally greater than properties located onshore. The Company s assets and operations are primarily concentrated on a small group of properties.

Significant Accounting Policies

Basis of Presentation

The Company s financial statements, and the notes to financial statements, are prepared in accordance with U.S. generally accepted accounting principles.

Oil and Natural Gas Properties and Depreciation, Depletion and Amortization

The Company utilizes the successful efforts method of accounting for its oil and natural gas properties. Under the successful efforts method, lease acquisition costs are initially capitalized. Exploratory drilling costs are also capitalized pending determination of proved reserves. If proved reserves are not discovered, these costs are expensed. All development costs are capitalized. Non-drilling exploratory costs, including geological and geophysical costs and rentals, are expensed as incurred. Unproved leaseholds with significant acquisition costs are assessed periodically, on a property-by-property basis, and a loss is recognized to the extent, if any, that the cost of the property has been impaired. Unproved leaseholds whose acquisition costs are not individually significant are aggregated, and such costs estimated to ultimately prove nonproductive, based on experience, are amortized over an average holding period. As unproved leaseholds are determined to be productive, the related costs are transferred to proved leaseholds. Provision for depletion is determined on a depletable unit basis using the unit-of-production method. As of December 31, 2004, 2003 and 2002 there were no unproved leasehold costs recorded. The depletion rates per Mcfe for the years ended December 31, 2004, 2003 and 2002 were $2.09, $1.09 and $3.02, respectively. The increase for the year ended December 31, 2004 was due to a significant downward revision of natural gas reserves. The significant decrease for the year ended December 31, 2003 was due to the impairment of oil and natural gas properties recorded during the year ended December 31, 2002 which substantially reduced the cost subject to depletion during 2003.

The Company performs a review for impairment of proved oil and natural gas properties on a depletable unit basis each quarter and when circumstances suggest there is a need for such a review. For each depletable unit determined to be impaired, an impairment loss equal to the difference between the sum of the carrying value and anticipated future costs, including plugging and abandonment, and the fair value of the depletable unit will be recognized. Fair value, on a depletable unit basis, is estimated to be the present value of expected future cash flows computed by applying estimated future oil and natural gas prices, as determined by management, to estimated future production of oil and natural gas reserves over the economic lives of the reserves discounted at 10%. Future cash flows are based upon the Company s estimate of proved reserves.

PANACO, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)

During 2002, the Company recorded an oil and natural gas asset impairment totaling $23.3 million. The impairment was primarily due to lower estimates of future net cash flow from the Company s proved reserves caused mainly by an increase in the estimate of future obligations to plug and abandon the wells and platforms used on its properties and a negative revision to previous estimates of total proved oil and natural gas reserves. The Company was not required to record any oil and natural gas asset impairments in 2004 and 2003.

Revenue Recognition

The Company recognizes its ownership interest in oil and natural gas production as revenue as it is produced and sold. Natural gas balancing arrangements with partners in natural gas wells are accounted for by the entitlements method. Fees for processing oil and natural gas for others are recorded as they are earned and treated as a reduction of lease operating expense related to the facilities and infrastructure since they are a reimbursement of operating costs of the facilities.

Earnings Per Share

Basic earnings (loss) per share is computed by dividing net earnings or loss by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share is computed by dividing net earnings or loss by the weighted average number of shares outstanding, after giving effect to potentially dilutive common share equivalents outstanding during the period. Potentially dilutive common share equivalents are not included in the computation of diluted earnings (loss) per share if they are anti-dilutive. Diluted earnings (loss) per common share are the same as basic earnings (loss) per share for all periods presented because no dilutive common share equivalents existed.

In connection with the Plan, all of the Old Common Stock outstanding as of November 16, 2004 was canceled and 1,000 shares of Panaco, Inc. New Common Stock were issued. Since the number of shares of the Old Common Stock and the New Common Stock are not comparable, the weighted average number of common shares outstanding is not meaningful, therefore, the earnings per share computation for the period ended December 31, 2004 has been omitted from the statement of operations and throughout the footnote disclosures contained herein. If the New Common Stock had been outstanding for the entire year ending December 31, 2004, the net income per common share would have been $88,423 per New Common Stock share.

Cash and Cash Equivalents

For purposes of reporting cash flows, the Company considers all cash investments with original maturities of three months or less to be cash equivalents.

Stock-Based Compensation

The Company has adopted Statement of Financial Accounting Standards (SFAS) No. 123 *Accounting for Stock Based Compensation,* (SFAS NO. 123). Under SFAS No. 123, the Company is permitted to either record expenses for stock options and other employee compensation plans based on their fair value at the date of grant or to continue to apply the current accounting policy under Accounting Principles Board, (APB) Opinion No. 25 *Accounting for Stock Issued to Employees,* (APB No. 25) and recognize compensation expense, if any, based on the intrinsic value of the equity instrument at the measurement date. In December of 2002, the Financial Accounting Standards Board (FASB) issued SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure An Amendment to FASB Statement No. 123,* (SFAS No. 148) to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. The Company elected to not change to the fair value based method of accounting for stock based employee compensation and continues to follow APB No. 25 and when required, to provide the pro forma disclosures required by

PANACO, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)

SFAS No. 123. Additionally, SFAS No. 148 amended disclosure requirements of SFAS No. 123 to require more prominent disclosure in both annual and interim financial statements.

Had compensation costs for the stock option plan been determined based on the fair value at the grant date, consistent with the provisions of SFAS No. 123, net income (loss) and net income (loss) per share would have increased or decreased to the pro forma amounts indicated below for the years ended December 31:

	2004	2003	2002
Net income (loss) as reported	$ 88,423,000	$ (3,478,000)	$ (51,675,000)
Plus: stock-based compensation expense determined using the intrinsic value of the option at the measurement date			
Less: stock-based employee compensation determined under fair value method for all awards granted to employees		(34,000)	(77,000)
Net income (loss) pro forma	$ 88,423,000	$ (3,512,000)	$ (51,752,000)
Basic and diluted net income (loss) per share as reported		$ (0.14)	$ (2.12)
Basic and diluted net income (loss) per share pro forma		$ (0.14)	$ (2.12)

When determining the fair value of each option granted the Company uses the Black-Scholes Option Pricing Model and considers the following weighted average assumptions: fair market price of the underlying common stock on the date of grant, expected stock price volatility, risk free interest rate, average expected option lives and forfeiture rate. The Company did not grant options to employees during the years ended December 31, 2004, 2003 and 2002 (see Note 8).

Fair Value

The Company values financial instruments as required by SFAS No. 107, *Disclosures about Fair Value of Financial Instruments.* The carrying amount of cash is fair value and the carrying amount of other balance sheet financial instruments approximate fair value on the date of each balance sheet.

Asset Retirement Obligations

During 2003, the Company implemented SFAS No. 143, *Accounting for Long-Term Asset Retirement Obligations,* (SFAS No. 143). As required by SFAS No. 143, the Company recorded a charge for the cumulative effect of accounting change of $12.1 million, which represents the accretion expense on the asset retirement obligation liability and depletion expense on the asset retirement obligation asset for the period from when the wells and platforms were either drilled or acquired through December 31, 2002 (see Note 3).

Restricted cash

Under the terms of a cash collateral order entered by the United States Bankruptcy Court during December 2003, the Company established an escrow account for its excess cash as defined in the order. On the Effective Date of the Plan, the requirement to maintain restricted cash was no longer necessary and since the Effective Date such cash has been available for working capital, capital expenditures, settlement of claims, and for general operations of the Company.

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PANACO, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)

Accounts Receivable

The Company reviews its accounts receivable on a regular basis and when appropriate, records an allowance when conditions warrant that such account may not be collectible. The total allowance for doubtful accounts was $5.9 million and $5.8 million at December 31, 2004 and 2003, respectively.

Pipelines and Other Property, Plant and Equipment

Property and equipment is carried at cost. Oil and natural gas pipelines and equipment are depreciated on the straight-line method over their estimated lives, primarily fifteen years. Other property is also depreciated on the straight-line method over their estimated lives, ranging from three to ten years.

Amortization of Deferred Debt Costs

Costs incurred in debt financing transactions are typically amortized over the term of the debt instrument using the effective interest rate method. During the year ended December 31, 2002, the Company wrote-off the balance of its deferred debt costs totaling $962,000 related to the Senior Notes due to a potential compromise of the principal. The amount was recorded as a component of reorganization costs.

Natural gas Imbalances

The Company accounts for its natural gas sales under the entitlement method. As such, the Company records its contractual percentage (entitled) of production as revenue and any amounts sold in excess of what the Company is entitled to, or not sold to which the Company is entitled to, are recorded as an imbalance with the other parties to the contract. The values of such imbalances are based on the prices received by the Company during the month in which the imbalance occurs. At December 31, 2004, the Company s imbalance was an under-produced, or asset balance of $0.4 million which has been recorded within accounts receivable other. At December 31, 2003, the Company s imbalance position was an over-produced, or payable balance of $1.3 million.

Derivative Instruments and Hedging Activities

As conditions warrant, the Company hedges the prices of its oil and natural gas production through the use of oil and natural gas swap contracts and put options within the normal course of its business. To qualify as hedging instruments, swaps or put options must be highly correlated to anticipated future sales such that the Company s exposure to the risk of commodity price changes is reduced. All hedge transactions are subject to the Company s risk management policy. The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking the hedge. This process includes specific identification of the hedging instrument and the hedge transaction, the nature of the risk being hedged and how the hedging instrument s effectiveness will be assessed. Both at the inception of the hedge and on an ongoing basis, the Company assesses whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items.

Effective January 1, 2001, the Company adopted SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities.* This statement was amended by SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities, an amendment of FASB Statement No. 133.* These statements establish accounting and reporting standards requiring that derivative instruments (including certain derivative instruments embedded in other contracts) be recorded at fair market value and included in the balance sheet as assets or liabilities. The accounting for changes in the fair value of a derivative instrument depends on the intended use of the derivative and the resulting designation, which is established at the inception of a derivative. Special accounting for qualifying hedges allows a derivative s gains and losses to offset related results on the hedged item in the statement of operations. For derivative instruments designated as cash flow

PANACO, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)

hedges, changes in fair value, to the extent the hedge is effective, are recognized in other comprehensive income until the hedged item is recognized in earnings. Hedge effectiveness is measured at least quarterly based on the relative changes in fair value between the derivative contract and the hedged item over time. Any change in fair value resulting from ineffectiveness, as defined by SFAS No. 133, is recognized immediately in oil and natural gas sales. As of December 31, 2004, 2003 and 2002, the Company did not have any open derivative agreements that qualified as a hedge instrument in accordance with SFAS No. 133.

At December 31, 2004, the Company had certain no-cost commodity price collars that management elected to not designate as hedge instruments for accounting purposes. Accordingly, the change in unrealized gains and losses are included in oil and natural gas sales. These derivative agreements are for 2005 production thus there have been no cash settlements recorded in 2004. For the year ended December 31, 2002, realized losses on hedging settlements totaled $282,000.

While the use of derivative contracts can limit the downside risk of adverse price movements, it may also limit future gains from favorable movements. The Company addresses market risk by selecting instruments whose value fluctuations correlate strongly with the underlying commodity. Credit risk related to derivative activities is managed by requiring minimum credit standards for counterparties, periodic settlements, and mark to market valuations.

The following is a summary of the oil and natural gas no-cost commodity price collars entered into by the Company.

Date of Contract	Volume/Month	Beginning	Ending	Floor	Ceiling
November 2004	25,000 Bbls	January 2005	December 2005	$ 42.50	$ 46.00
November 2004	150,000 MMBTU	January 2005	December 2005	$ 6.00	$ 8.35

At December 31, 2004, a liability of $0.9 million was recorded by the Company in connection with these contracts to record the derivative instruments at their fair market value.

Income Taxes

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

Environmental Liabilities

The Company accrues for losses associated with environmental remediation obligations when such losses are probable and can be reasonably estimated. Accruals for estimated losses from environmental remediation obligations generally are recognized no later than the time of the completion of the remedial feasibility study. These accruals are adjusted as further information develops or circumstances change. Costs of future expenditures for environmental remediation obligations are not discounted to their present value. Recoveries of environmental remediation costs from other parties are recorded as assets when their receipt is deemed probable. As of December 31, 2004, 2003 and 2002, the Company did not have any liabilities related to environmental remediation that were required to be recorded.

PANACO, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)

Concentration of Credit Risk

Substantially all of the Company s accounts receivable result from oil and natural gas sales or joint interest billings to third parties in the oil and natural gas industry. This concentration of customers and joint interest owners may impact the Company s overall credit risk in that these entities may be similarly affected by changes in economic and other industry conditions. The Company does not require collateral from its customers. Further, the Company generally has the right to offset revenue against related billings to joint interest owners. Derivative contracts subject the Company to a concentration of credit risk. The Company transacts the majority of its derivative contracts with one counterparty.

Use of Estimates

The preparation of financial statements in accordance with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and disclosure of contingent assets and liabilities in the financial statements. The most significant estimates include the use of estimates for oil and natural gas reserve information, fair market values of derivative instruments, the valuation allowance for deferred income taxes, the valuation allowance for accounts receivable, the asset retirement obligation for plugging and abandonment of wells and platforms, impairments tests and depletion expense. Actual results could differ from those estimates. Estimates related to oil and natural gas reserve information are based on estimates provided by independent petroleum engineering firms. Changes in oil and natural gas prices could significantly affect the estimates from year to year, thus directly affecting the rate of depletion, impairment tests and valuation allowances on deferred tax assets and accounts receivable.

Recently Issued Accounting Pronouncements

In December 2004, the FASB issued SFAS No. 123(R), *Share-Based Payment.* This statement requires companies to measure the cost of employee services in exchange for an award of equity instruments based on a grant-date fair value of the award (with limited exceptions), and that cost must generally be recognized over the vesting period. SFAS No. 123(R) amends the original SFAS No. 123 and SFAS No. 95 that had allowed companies to choose between expensing stock options or showing pro forma disclosure only. This statement eliminates the ability to account for share-based compensation transactions using APB Opinion No. 25. We currently account for our stock-based compensation plans under the principles prescribed by APB Opinion No. 25. Accordingly, no stock option compensation cost is reflected in net income, as all options granted under the plan had an exercise price equal to or less than the market value of the underlying common stock on the date of grant. The adoption of SFAS No. 123(R) will not impact our results of operations since the Company has no options outstanding. SFAS No. 123(R) becomes effective as of the beginning of the first interim or annual reporting period that begins after June 15, 2005.

In December 2004, SFAS No. 153, *Exchanges of Nonmonetary Assets an Amendment of APB Opinion No. 29* is effective for fiscal years beginning after June 15, 2005. This statement addresses the measurement of exchange of nonmonetary assets and eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets in paragraph 21(b) of APB Opinion No. 29, *Accounting for Nonmonetary Transactions* and replaces it with an exception for exchanges that do not have commercial substance. The Company expects the adoption of SFAS No. 153 to have no impact on its financial statements.

Note 3 Asset Retirement Obligations

The Company s asset retirement obligations (ARO) relate to the plugging and abandonment of its oil and natural gas properties. The provisions of SFAS No. 143 requires the fair value of a liability for an ARO to be recorded and a corresponding increase in the carrying amount of the associated asset. The cost of the

PANACO, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)

tangible asset, including the initially recognized asset retirement cost (ARC) is depleted over the useful life of the asset. If the fair value of the estimated ARO changes in the future, an adjustment is recorded to the retirement obligation and the asset retirement cost. The offsetting ARO liability is recorded at fair value, and accretion expense recognized as the discounted liability is accredited to its expected settlement value. The fair value of the ARO asset and liability is measured using expected future cash out flows discounted at the Company s credit adjusted risk free interest rate. Differences in actual amounts incurred to plug and abandon a well or platform are compared to the amounts that have been accrued are recorded as a gain or loss upon settlement of the liability.

The Company adopted SFAS No. 143 on January 1, 2003 which resulted in a net increase in the discounted ARO liability of $42.1 million and an increase in net oil and natural gas properties of $30 million. The related cumulative effect of implementing SFAS No. 143 since inception resulted in a non-cash charge to earnings of $12.1 million. There was no impact on the Company s cash flow or estimates of its plugging and abandoning costs as a result of adopting SFAS No. 143.

The following table provides a roll forward of the ARO for the years ended December 31:

	2004	2003
ARO at beginning of period	$ 43,933,000	$ 42,118,000
Revision of estimate	2,680,000	
Liabilities settled	(207,000)	(1,028,000)
Accretion expense	3,132,000	2,843,000
ARO at end of period	$ 49,538,000	$ 43,933,000

On a pro forma basis, for the year ended December 31, 2002, depletion expense would have decreased by $6.8 million, the impairment of oil and natural gas properties would have decreased by $5 million and accretion expense would have increased by $2.7 million decreasing the overall net loss to $42.6 million or $(1.74) per share.

Note 4 Restricted Deposits

Pursuant to existing agreements with former property owners and in accordance with requirements of the U.S. Department of Interior s Minerals Management Service (MMS), the Company has put in place surety bonds and/or escrow agreements to provide satisfaction of its eventual responsibility to plug and abandon wells and remove structures when certain fields are no longer in use. As part of its agreement with the underwriter of the surety bonds, the Company has established bank trust and escrow accounts in favor of either the surety bond underwriter or the former owners of the particular fields. Restricted deposits are recorded on an accrual basis and are funded based upon the terms of the escrow agreements. Certain amounts are required to be paid upon receipt of proceeds from production. As of December 31, 2004 and 2003, $1.9 million and $0.7 million, respectively, have been accrued representing amounts owed that have not been funded.

In the West Delta fields and the East Breaks 109 and 110 fields, the Company established an escrow for both fields in favor of the surety bond underwriter, who provides a surety bond to the former owners of the West Delta fields and to the MMS. The balance in this escrow account was $8.8 million at December 31, 2004 and is fully funded per the terms of the escrow agreement.

In the East Breaks 165 and 209 fields, the Company established an escrow account in favor of the surety bond underwriter, who provides surety bonds to both the MMS and the former owner of the fields. The balance in this escrow account was $6.6 million at December 31, 2004, which is fully funded per the terms of the escrow agreement.

PANACO, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)

The Company has also established an escrow account in favor of a major oil company under which the Company will deposit 10% of the net cash flows from the properties, as defined in the agreement, that were acquired from the major oil company. This balance in this escrow account was $2.9 million at December 31, 2004.

Pursuant to an order entered by the United States Bankruptcy Court during 2003, the Company established the Unocal Escrow Account which requires monthly deposits based on cash flows from certain wells acquired, as defined in the agreement. The balance in this escrow account was $3.2 million at December 31, 2004.

Pursuant to an agreement entered into with the MMS during December 2004, the Company established the East Breaks Escrow Accounts which require an initial deposit of $2.0 million and quarterly deposits of $0.8 million beginning March 2005. The balance in this escrow account was $2.0 million at December 31, 2004.

Aggregate payments to the East Breaks Escrow accounts for the five years following December 31, 2004 are as follows:

Year Ended December 31,		
2005	$	3,200,000
2006		3,200,000
2007		3,200,000
2008		3,200,000
2009		3,200,000
Thereafter		2,000,000
	$	18,000,000

Note 5 Debt

The Company s outstanding debt as of December 31 is as follows:

		2004		**2003**
Subject to compromise:				
10.625% Senior Notes due 2004	$		$	100,000,000
Not subject to compromise:				
Revolving Credit Facility due 2003	$		$	35,272,000
Term loan due 2011 related party		38,000,000		
Total long-term debt		38,000,000		35,272,000
Less current maturities		(5,429,000)		(35,272,000)
Long-term debt, less current maturities	$	32,571,000	$	

Senior Notes

In October 1997, the Company issued $100 million of 10.625% Senior Notes due 2004. Interest was payable semi-annually on April 1 and October 1 of each year. The Senior Notes were general unsecured obligations of the Company and ranked senior in right of payment to any subordinated obligations. The Senior Note Indenture contained certain restrictive covenants that limited the ability of the Company and its subsidiaries to, among other things, incur additional indebtedness, pay dividends or make certain other

PANACO, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)

restricted payments, consummate certain asset sales, enter into certain transactions with affiliates, incur liens, impose restrictions on the ability of a restricted subsidiary to pay dividends or make certain payments to the Company and its restrictive subsidiaries, merge or consolidate with any other person or sell, assign, transfer, lease, convey or otherwise dispose of all or substantially all of the assets of the Company. In addition, under certain circumstances, the Company was required to offer to purchase the Senior Notes, in whole or in part, at a purchase price equal to 100% of the principal amount thereof plus accrued interest to the date of repurchase, with the proceeds of certain asset sales. As referred to in Note 1, on the Effective Date of the Plan, 51% of the Senior Notes were exchanged for 100% ownership of the reorganized Company in which such note holders received 1,000 shares of New Common Stock. These notes were held by an affiliate of a primary shareholder immediately prior to the confirmation of the Plan who then became the single shareholder of the Company. Holders of the remaining 49% of the Senior Notes were paid a cash payment equal to 2.5% of the face amount of the Senior Notes (see Note 1).

Revolving Credit Facility

In November 2001, the Company amended the Credit Facility originally entered into in October 1999. The Credit Facility was for two years and provided a borrowing base of up to $40 million, depending on the borrowing base as calculated in accordance with the agreement. In May 2004, the Credit Facility was assumed by Mid River, LLC, a related party, the proponent of the Company s Plan of Reorganization. In November 2004, the Company converted the Credit Facility into the term loan described below.

Term Loan

In November 2004, the Company entered into a term loan agreement (the Term Loan) for $38,000,000 with Mid River, LLC, a related party, which matures on December 15, 2011. The Term Loan accrues interest at Wall Street Journal LIBOR plus 4% (6.35% at December 31, 2004) and is payable in quarterly principal installments of $1,357,143 plus interest commencing March 15, 2005 with all unpaid interest and principal due at maturity. The loan is secured by all of the assets of the Company.

Production Payment

Production payment represents an obligation to a former lender, which is repaid from a portion of the cash flows from certain wells. The production payment is a non-recourse loan related to the development of certain wells acquired. The agreement requires repayment of principal plus an amount sufficient to provide an internal rate of return of 18%. During 2003, the wells associated with the production payment ceased production and eliminated any further obligation by the Company to repay the indebtedness. The remaining production payment balance of $2.2 million was written off during the year ended December 31, 2003 and it was recorded as gain on expiration of production payment.

PANACO, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)

Aggregate maturities of principal of long-term debt-related party for the five years following December 31, 2004 are as follows:

Year Ended December 31,		Long-Term Debt
2005	$	5,429,000
2006		5,429,000
2007		5,429,000
2008		5,429,000
2009		5,429,000
Thereafter		10,855,000
	$	38,000,000

Note 6 Major Customers

During the years ended December 31, 2004, 2003 and 2002, Plains Marketing, LLC, the purchaser of a majority of the Company s oil production, accounted for approximately 31%, 30% and 24%, respectively, of total oil and natural gas sales. During the years ended December 31, 2004 and 2003, Louis Dreyfus Energy Services, the purchaser of a majority of the Company s natural gas production, accounted for 40% and 45% of total oil and natural gas sales and during the year ended December 31, 2002, Reliant Energy accounted for approximately 33% of total oil and natural gas sales, respectively.

Note 7 Income Taxes

The (provision) benefit for United States (U.S.) federal income taxes for the years ended December 31 are as follows:

		2004		2003		2002
Current	$	(407,000)	$		$	
Deferred		23,284,000				
	$	22,877,000	$		$	

The reconciliation of income taxes computed at the U.S. federal statutory tax rates to the benefit for income taxes for the years ended December 31 is as follows:

	2004	2003	2002
Statutory federal income tax rate expense (benefit)	35%	35%	(35)%
Other	%	11%	1%
Change in valuation allowance	(70)%	(46)%	34%
	(35)%	%	%

PANACO, INC.
NOTES TO FINANCIAL STATEMENTS (Continued)

The income tax effects of temporary differences between financial and income tax reporting that gave rise to deferred income tax assets and liabilities as of December 31 are as follows:

	2004	2003
Deferred tax assets		
Net operating loss carryforwards	$ 14,917,000	$ 38,393,000
Asset retirement obligation accretion	6,343,000	6,516,000
Fixed asset basis differences		3,152,000
Allowance for bad debts	2,081,000	2,046,000
State taxes	795,000	2,615,000
AMT tax credits	610,000	290,000
Total deferred tax assets	24,746,000	53,012,000
Less valuation allowance		(53,012,000)
Total net deferred tax assets	24,746,000	
Deferred tax liabilities		
Fixed asset basis differences	(1,324,000)	
Natural gas balancing	(138,000)	
Total deferred tax liabilities	(1,462,000)	
Net deferred tax assets (liabilities)	$ 23,284,000	$

The net change in the valuation allowance for deferred income tax assets was a decrease of $53.0 million in 2004. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. As of December 31, 2004, Management has determined that the realization of the Company s deferred tax assets is more likely than not and has reversed the valuation allowance on the deferred tax assets. The reversal of the valuation allowance resulted in the recording of a net $23 million tax benefit on the Company s statement of operations for the year ended December 31, 2004.

At December 31, 2004, the Company has estimated net operating loss carryforwards available for federal income tax purposes of approximately $42.6 million which begin to expire in 2019.

Note 8 Stock Options

During 1992, the shareholders approved a long-term incentive plan allowing the Company to grant incentive and non-statutory stock options, performance units, restricted stock awards and stock appreciation rights to key employees, directors, and certain consultants and advisors of the Company up to a maximum of 20% of the total number of common shares outstanding.

During 2000, the Company issued 500,000 options at $1.92 per share, the market closing price on the grant date of August 16, 2000, to officers of the Company. Through December 31, 2001, 75,000 of the options expired unexercised or were cancelled. The options vest ratably over five years and expire six years from the grant date.

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A summary of the status of the Company s stock options at December 31 is presented in the table below:

	2004		2003		2002	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	100,000	$ 1.92	225,000	$ 1.92	425,000	$ 1.92
Granted						
Exercised						
Forfeited					(200,000)	1.92
Cancelled	(100,000)	1.92	(125,000)	1.92		
Outstanding at end of year			100,000	1.92	225,000	1.92
Exercisable at end of year			60,000	$ 1.92	90,000	$ 1.92
Unexercisable at end of year			40,000	1.92	135,000	1.92

Upon reorganization of the Company during November 2004, all incentive stock options outstanding were cancelled.

Note 9 Related Party Transactions

On November 3, 2004, the United States Bankruptcy Court for the Southern District of Texas issued an order which became effective on November 16, 2004 confirming a plan of reorganization for the Company. Affiliates of Mr. Carl C. Icahn own all of the outstanding stock of the reorganized Company.

During the year ended December 31, 2004, the Company has entered into the transactions listed below with various entities which are directly or indirectly controlled by Mr. Carl C. Icahn:

At December 31, 2004, the balance sheet reflects a term loan payable of $38 million, and related interest payable of $0.3 million. During the year ended December 31, 2004, the Company recorded interest expense of $1.6 million and a loss on restructuring of debt of $3.6 million associated with this related party.

The Company entered into a Management Agreement with an entity pursuant to the Bankruptcy Court s Order confirming the effective date of the Plan. In exchange for management services provided by that entity, the Company pays a monthly fee equal to the actual direct and indirect administrative overhead costs that the entity incurs in operating and administering the Company s oil and natural gas properties plus 15% of such costs. The Company recorded $0.7 million in management fee expense under this agreement and $0.2 of general and administrative expense for the year ended December 31, 2004. At December 31, 2004 the balance sheet reflects accounts payable of $0.6 million owed under the agreement.

Note 10 Commitments and Contingencies

The Company is subject to various legal proceedings and claims that arise in the ordinary course of business. In the opinion of management, the amount of liability, if any, with the respect to these actions would not materially affect the financial position of the Company or its results of operations.

The company had an operating lease for office space which was cancelled effective November 30, 2004. Total rent expense was $442,469, $371,711 and $380,244 for the years ended December 31, 2004, 2003 and 2002, respectively.

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NOTES TO FINANCIAL STATEMENTS (Continued)

Note 11 Subsequent Events

During January 2005, the Company approved and entered into an Agreement and Plan of Merger with National Offshore LP, a related party. As of March 18, 2005, the merger has not been consummated.

In the first quarter of 2005, the Company made non-interest bearing advances of $10 million to a related party.

In February 2005, the Company entered into a hedging agreement for 5,000 barrels of oil and 40,000 MMBTU of natural gas per month effective for production months March 2005 through December 2005 and a second hedging agreement for 17,000 barrels of oil and 140,000 MMBTU of natural gas effective for production months January 2006.

In March 2005, the Company sold 100% of its interest in the West Delta 52-58 properties and 60% of its interest in a newly acquired lease in West Delta 56 for the assumption by the buyer of all of the environmental, general, plugging and abandonment and other liabilities related to these properties effective January 1, 2005. In connection with the sale, the Company agreed to transfer to the buyer $4.7 million of escrow funds for plugging and abandonment liabilities.

Note 12 Supplemental Information Related to Oil and Natural Gas Producing Activities (Unaudited)

Capitalized Costs

The following table reflects the capitalized costs and