

# **Biloxi Marsh Lands Corporation**

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March 17, 2008

To the Shareholders of Biloxi Marsh Lands Corporation:

We are pleased to report that 2007 was the twelfth consecutive profitable year for your Company. Total revenue for the year ending December 31, 2007 was \$4,639,317 compared to total revenue of \$9,578,519 in 2006. The annual revenue breakdown is as follows: 2007 revenue from oil and gas activity was \$4,861,263 compared to revenue of \$8,662,416 in 2006. For 2007 total revenue includes a \$974,359 loss emanating from partnership income which represents the Company's interest in B&L Exploration, LLC compared to income of \$169,659 in the same category for the prior year. Dividend and interest income for 2007 was \$521,942 compared to \$790,481 for 2006. In 2007 we incurred a cumulative gain from the sale of investment securities in the amount of \$208,600 as compared to a cumulative loss from the sale of investment securities \$59,088 in 2006. Meanwhile, expenses for the year totaled \$1,432,138 compared to \$1,640,095 for the prior year. For the year net earnings were \$2,340,175 or \$.85 per share compared to \$5,551,599 or \$2.02 per share in 2006. Due to the Company's earnings exceeding the revenue threshold tests under the income tax regulations, the Company was required to file its income tax returns using the accrual basis of tax accounting. In order to achieve consistency in reporting, effective January 1, 2007, the Company has changed its method of financial reporting from the cash receipts and disbursements method of reporting to the accrual method of reporting. For comparative purposes we have adjusted our *Statement of Revenues and Expenses and Retained Earnings* for 2006 to reflect the accrual method of reporting. The change in our reporting method has no material effect on our cash flows.

We reported at the end of 2005 that the Company had approximately 82,000 acres open and available for exploration and development. This clearly indicated the need for management to take steps to jumpstart drilling activity. In December of 2006 we announced the formation of B & L Exploration, LLC (BLX) of which the Company owns 75% with the remaining 25% being owned by Lake Eugenie Land & Development, Inc. (LKEU). BLX subsequently placed drilling packages with the Manti Group and a group led by Kaiser-Francis Gulf Coast, Ltd and Gulf Production Company. As the result of the placement of these drilling packages BLX participated in the drilling of five wells during 2007 with three wells being successfully completed and two wells being abandoned as dry-holes. During the fourth quarter of 2007 two of these wells were placed on production and as of December 31, 2007 were producing natural gas at a combined daily rate of approximately 8.5 mmcf with net daily production accruing to BLX of approximately 1.6 mmcf. The third well is awaiting the construction of a pipeline. We anticipate that the pipeline should be completed and this well placed on production by the end of the second quarter of 2008. All three of these wells are located off of Company property in state waters and represents the first time that the Company has had royalty revenues from sources outside the boundaries of our property. BLX is scheduled to participate with the group led by Kaiser-Francis and Gulf Production in the drilling of two additional wells during the first half of 2008 and is working independently on the development and placement of additional shallow and deep prospects.

On January 31, 2008 we announced our participation in the NAPE Expo in Houston, Texas. With the assistance of BLX's technical consultants we presented acreage under control of BLX showing two Tuscaloosa prospects (Alpha and Beta) developed over the past 12 to 18 months using existing geological well control and 3D seismic data (see the Company's website [www.biloximarshlandscorp.com](http://www.biloximarshlandscorp.com)). While we are encouraged by the interest expressed in these prospects during the NAPE Expo and subsequent follow up, these deeper Tuscaloosa prospects are much more difficult to place than the shallower drilling packages previously placed by BLX.

As of December 31, 2007 the combined gross daily production rate from 9 wells operated by the Company's mineral Lessees was approximately 14.6 million cubic feet (mmcf) with net daily production accruing to the Company of approximately 1.5 mmcf. Combining this daily natural gas production with the Company's proportional share of the daily production from the two new BLX wells makes the total net daily production accruing to the Company as December 31, 2007 approximately 3.1 mmcf, an increase over the 2.4 mmcf cumulative daily production accruing to the Company at the end of 2006.

The Company again commissioned T. J. Smith & Company, Inc., independent reservoir engineers, to complete a proved reserve study. This reserve study estimates that as of December 31, 2007 the Company's "Developed Producing" (PDP) reserves are .914 billion cubic feet (bcf) of natural gas and estimates that the "Developed Non-Producing" (PDNP) reserves are .622 bcf, with the "Proved Un-Developed" (PUD) reserves being 1.012 bcf, totaling 2.549 bcf of estimated proved reserves (see "Appendix A" for definitions of reserve classifications). While for the years ending 2006 and 2007 the total amount of proved natural gas reserves remained constant at approximately 2.5 bcf the "Proved Developed Producing" (PDP) reserves actually decreased year over year from approximately 1.5 bcf to .91 bcf, a decrease of .59 bcf in PDP reserves (see note 5 below). Additionally, this reserve study estimates that slightly more than 26% of the PDP and PDNP reserves directly attributable to the Company will deplete by the end of 2008.

Please find the following table showing the Company's proved reserves as of December 31, 2007:

**Proved Reserves as of December 31, 2007 (3), (5)**

	<u>Developed Producing (PDP)</u>	<u>Developed Non-Producing (PDNP)</u>	<u>Proved Un-Developed (PUD)</u>	<u>Total</u>
	(Dollars in thousands)			
Net Proved Reserves (1):				
Natural Gas (BCF):	.9144	.6223	1.0121	2.5488
Estimated Future Net Revenues (before income taxes) (2):.....			\$	16,861 (4)
Estimated Discounted Future Net Revenues (before income taxes) (2):.....			\$	12,553 (4)

(1) In general, our engineers based their estimates of economically recoverable oil and natural gas reserves and of the future net revenues therefrom on a number of variable factors and assumptions, such as historical production from the subject properties, the assumed effects of regulation by governmental agencies and assumptions concerning future oil and natural gas prices, all of which may vary considerably from actual results. All such estimates are to some degree speculative, and classifications of reserves, that are based on the mechanical status of the completion, may also define the degree of speculation involved. For these reasons, estimates of the economically recoverable oil and natural gas reserves attributable to any particular group of wells, classifications of such reserves based on risk of recovery and estimates of the future net revenues expected therefrom, prepared by different engineers or by the same engineers at different times, may vary substantially. Therefore, the actual production, revenues, and severance taxes with respect to reserves likely will vary from such estimates, and such variances could be material.

Estimates with respect to proved reserves that may be developed and produced in the future are often based on volumetric calculations and by analogy to similar types of reserves rather than actual production history. Estimates based on these methods are generally less reliable than those based on actual production history, and subsequent evaluation of the same reserves, based on production history, will result in variations, which may be substantial, in the estimated reserves.

In accordance with applicable requirements of the Commission, the estimated discounted future net revenues from estimated proved reserves are based on prices as of the date of the estimate. Actual future prices may be materially higher or lower. Actual future net revenues also will be affected by factors such as actual production, supply and demand for oil and natural gas, curtailments or increases in consumption by natural gas purchasers, changes in governmental regulations or taxation and the impact of inflation on costs.

(2) The Estimated Discounted Future Net Revenues represents the Estimated Future Net Revenues before income taxes discounted at 10%. For calculating The Estimated Future Net Revenues and the Estimated Discounted Future Net Revenues, we used the price as of December 31, 2007 which was \$6.788 per mmcf of natural gas.

(3) The Meridian Resource and Exploration, LLC and Manti Jamba, Ltd. separately operate the various producing wells. The Company has no control over operations and maintains only a landowner's mineral royalty interest. Please see footnote (i) following the final paragraph of this letter for a warning concerning forward-looking information.

(4) The value of the proved reserves "Undiscounted, M\$" and "Discounted at 10%, M\$" includes a minimal amount of Oil and Condensate as well as Natural Gas Liquids.

(5) The majority of "Proved Reserves as of December 31, 2007" and the related "Estimated Revenues" are "Proved Undeveloped" (PUD). The increase in this category over last year's PUD reserves was based on an increase of the Company's ownership interest in this category of reserves, not new discoveries. As is typical to PUD reserves there is currently no production related to this category and additional development drilling is necessary for production to commence. As of the date of this letter, there is no additional development drilling scheduled.

In addition to the foregoing estimated proved reserves, based on another proved reserve study completed by T. J. Smith & Company, Inc., as of December 31, 2007 the BLX's estimated proved reserves were 1.0263 billion cubic feet (bcf) of natural gas which, using the December 31, 2007 SEC price \$6.788 per mmcf, equates to "Estimated Future Net Revenues" of \$5.26mm with an "Estimated Discounted Future Net Revenues" of \$4.66mm (see note 2 above). Based upon the Company's seventy-five percent ownership of BLX the estimated reserves allocated to the Company are .77 bcf

of natural gas which equates to "Estimated Future Net Revenues" of \$3.95mm with an "Estimated Discounted Future Net Revenues" of \$3.5mm (see note 2 above). Combining the proved reserves in the foregoing table on page 2 with the Company's portion of BLX's estimated reserves makes the total estimated proved reserves accruing the Company 3.3 bcf of natural gas which equates to "Estimated Future Net Revenues" of \$20.81mm with an "Estimated Discounted Future Net Revenues" of \$16.05mm (see notes 2 & 5 above).

As previously reported, there is currently pending a possessory action suit which was filed by the Company on or about November 2, 2001 as the result of disturbances in the Company's possession of Sections 1, 2 & 3, T13S, R16E due to protective oil, gas & mineral leases granted to Manti Resources, Inc. (Manti) by particular Manuel Molero family members and also to Louis and Gustave Carmadelle family entities. Further disturbance in possession is the result of seismic permit/lease options and protective leases granted by the same parties to The Meridian Resource & Exploration LLC (Meridian) for disputed and productive acreage outside of the Manti lease. The Manuel Molero family members filed a declaratory judgment action with regard to the same acreage, which action was consolidated with the Company's possessory action. Additionally, Manti filed a concursus proceeding, and deposited funds into the registry of the court representing royalties attributable to the conflict acreage in the producing unit. Meanwhile, Meridian has also filed concursus proceedings with respect to additional producing units formed which contain conflict acreage. Consolidation of the concursus proceedings with the possessory action and declaratory judgment action above mentioned has been granted by the court. Management intends to vigorously pursue the Company's possessory action and vigorously defend against the Molero family members' declaratory judgment action. During 2007, discovery was conducted by the Company's attorneys as preparations for trial of the aforesaid litigation continues.

The Carmadelle entities continued their strategy of attempting to have the trial court determine an issue related to title. In 2007, for the fifth time, the Louis and Gustave Carmadelle family entities, yet again, tried to have the issue of their title litigated prior to the determination of the Company's possessory action by filing new litigation in the United States District Court in New Orleans against the Company, Manuel Molero family members, the Assessor of St. Bernard Parish, the Sheriff of St. Bernard Parish and the Clerk of Court of St. Bernard Parish. The Company immediately moved to have this new suit dismissed or, in the alternative, have the federal court abstain from hearing the new lawsuit because of the pending state court litigation. The case was initially assigned to Judge Ginger Berrigan and later re-assigned to Judge Thomas Porteous. The Louis and Gustave Carmadelle family entities then filed a motion to recuse Judge Porteous which the Company and the Manuel Molero family members opposed. In February of 2008, such motion to recuse was denied. After several continuances, the Company's motion to dismiss or to abstain is currently set for hearing in March of 2008. The Company intends to vigorously defend this litigation while exploring all avenues of bringing this matter to resolution.

In addition to the above described competing claims to the subject acreage, there are also competing claims between the Company and the State of Louisiana regarding certain tracts within each producing unit ("Concursus Proceedings"). The object of the Concursus Proceedings is to determine whether the State or the Company is entitled to the royalty on production attributable to the disputed acreage. The judgments ultimately rendered in these proceedings will order the distribution of royalty proceeds currently being deposited into the Registry of the Court. There is no potential in any of the litigation, including the Concursus Proceedings for rendition of an adverse judgment requiring the payment of Company funds. As of December 31, 2007, the Company's potential share of the funds deposited in the various concursus' accounts (if the Company is successful in winning all of the issues raised in all of the aforesaid litigation proceedings) is approximately 48 million dollars.

The timing of the resolution of the competing claims was impacted substantially by the effects of Hurricane Katrina on several of the witnesses involved and by damage to the St. Bernard Parish Courthouse and the records of the St. Bernard Parish Clerk of Court. As of the date of this letter the courtroom facilities have been adequately repaired and the Company does not anticipate any additional delays due to hurricane related issues.

For these reasons, as of the date of this report, there is no way to forecast a timetable for the conclusion of the Company's possessory action, the Manuel Molero family members' declaratory judgment action, the Louis and Gustave Carmadelle family entities' federal court action and the Concursus Proceedings.

Prior to 2004 the Company paid one dividend each year. During 2007 the Company returned to this custom of paying one dividend per calendar year, paying \$1.00 per share of outstanding common stock or \$2,754,428 in December of 2007. It is anticipated that the custom of paying one dividend per calendar year will be followed in 2008. It should be noted that the Company paid a dividend equating to slightly more than its net earnings during 2007 and since 2002 the Company has paid close to \$36,000,000 in total dividends.

We reported in last year's President's letter that prior to Hurricane Katrina we retained the services of T. Baker Smith, Inc. to develop *The Biloxi Marsh Stabilization and Restoration Plan*. After Hurricane Katrina we extended the scope of this project and retained additional technical experts to assist in formulating *The Biloxi Marsh Stabilization and Restoration Plan*. To enhance the surface of our property management is working closely with local, state and federal officials in an attempt to influence any restoration projects that may take place on or near the Company's property. As we continue to participate in the coastal restoration process *The Biloxi Marsh Stabilization and Restoration Plan* is proving to be a valuable tool to foster our participation and guide spending on restoration projects. During 2007 the State of Louisiana awarded the design contract for a major fresh water diversion from the Mississippi River into the St. Bernard Parish marshes at Violet, Louisiana to a group lead by Arcadis, US and T. Baker Smith, Inc. Not only was the Violet diversion a major component of our restoration plan Arcadis, US and T. Baker Smith, Inc. led the team of experts that we assembled to develop *The Biloxi Marsh Stabilization and Restoration Plan*. The awarding of this contact signals the initial success of our coastal restoration strategy and positions the Company favorably in the efforts to restore the marshes of St. Bernard Parish. A complete copy of *The Biloxi Marsh Stabilization and Restoration Plan* is available on our website [www.biloximarshlandscorp.com](http://www.biloximarshlandscorp.com).

We regret to inform you that one of our Directors and our Treasurer, Philip I. Zollinger, died Saturday, March 8, 2008 of a heart attack at the age of 55. Phil was a friend whose dedication to his friends and to the Company will be greatly missed by all. We extend our sincere sympathies to his family.

We remind our shareholders that St. Bernard Parish, Louisiana, the Parish where our property is located, was indescribably devastated by Hurricane Katrina and is struggling to recover. To assist in the Parish's rebuilding the Company has established and funded the Biloxi Marsh Disaster Relief Fund Company. Detailed information about the fund is available on its website [www.selarelief.com](http://www.selarelief.com). During 2006 the fund applied for and received IRS 501 (c) (3) tax exempt status making all contributions to the fund tax deductible. Those living outside the hurricane affected zone and all interested parties are asked to remember the people of St. Bernard Parish, Louisiana by donating to the Biloxi Marsh Disaster Relief Fund Company. You may send a check to the fund at the Company's address or contribute using a credit card on the Fund's website: [www.selarelief.com](http://www.selarelief.com)

Please remember to visit our website, [www.biloximarshlandscorp.com](http://www.biloximarshlandscorp.com) to obtain general information about the Company as well as recent historical annual reports and all historical press releases. We strongly recommend that all interested parties become familiar with the information available on the Company's website: [www.biloximarshlandscorp.com](http://www.biloximarshlandscorp.com). During January 2008 we moved our office to One Galleria Blvd., Suite #902. Complete and updated contact information is available on the Company's website.

We are pleased with the initial success of BLX and the corresponding increase in daily production rates and addition of proved reserves. We plan to continue to focus on our key asset which is Company's property while using all the assets at our disposal to find opportunities that will increase shareholder value. We are hopeful that 2008 will be another successful year.

Sincerely,



William B. Rudolf  
President and Chief Executive Officer  
Metairie, Louisiana  
Email: [wrbiloxi@bellsouth.net](mailto:wrbiloxi@bellsouth.net)<sup>1</sup>

<sup>1</sup> This letter contains forward-looking statements regarding oil and gas discoveries, oil and gas exploration, development and production activities and reserves. Accuracy of the forward-looking statements depends on assumptions about events that change over time and is thus susceptible to periodic change based on actual experience and new developments. The Company cautions readers that it assumes no obligation to update or publicly release any revisions to the forward-looking statements in this report. Important factors that might cause future results to differ from these forward-looking statements include: variations in the market prices of oil and natural gas; drilling results; unanticipated fluctuations in flow rates of producing wells; oil and natural gas reserves expectations; the ability to satisfy future cash obligations and environmental costs; additional drilling, and general exploration and development risks and hazards. Readers are cautioned not to place undue reliance on forward-looking statements made by or on behalf of the Company. Each such statement speaks only as of the day it was made. The factors described above cannot be controlled by the Company. When used in this report, the words "hopeful", "believes", "estimates", "plans", "expects", "should", "outlook", and "anticipates" and similar expressions as they relate to the Company or its management are intended to identify forward-looking statements.



**BILOXI MARSH LANDS CORPORATION**

Financial Statements – Income Tax Basis and Schedule

December 31, 2007 and 2006

(With Independent Auditors' Report Thereon)



**KPMG LLP**  
Suite 2900  
909 Poydras Street  
New Orleans, LA 70112

## **Independent Auditors' Report**

Board of Directors  
Biloxi Marsh Lands Corporation:

We have audited the accompanying statements of assets, liabilities, and stockholders' equity – income tax basis of Biloxi Marsh Lands Corporation (the Corporation) as of December 31, 2007 and 2006, and the related statements of revenues and expenses – income tax basis, changes in stockholders' equity – income tax basis, and cash flows – income tax basis, for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in note 1(b) to the financial statements, these financial statements were prepared on the basis of accounting the Corporation uses for income tax purposes, which is a comprehensive basis of accounting other than U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the assets, liabilities, and stockholders' equity of Biloxi Marsh Lands Corporation as of December 31, 2007 and 2006, and its revenues and expenses and cash flows for the years then ended, on the basis of accounting described in note 1(b).

The Corporation's financial statements for 2006 were previously prepared in conformity with the cash receipts and disbursements method of income tax accounting. As more fully described in note 1(b) to the financial statements, the Corporation elected, at the beginning of 2006, to prepare its financial statements on the accrual method of income tax accounting, which is a comprehensive basis of accounting other than U.S. generally accepted accounting principles. Consequently, the Corporation's financial statements for 2006 referred to above have been adjusted to conform to the accrual method of income tax accounting.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information included in the schedule of marketable securities as of December 31, 2007 and 2006 is presented for the purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

**KPMG LLP**

March 13, 2008

**BILOXI MARSH LANDS CORPORATION**

Statements of Assets, Liabilities, and Stockholders' Equity – Income Tax Basis

December 31, 2007 and 2006

<b>Assets</b>	<b>2007</b>	<b>2006</b>
Current assets:		
Cash and cash equivalents	\$ 2,197,864	1,232,846
Marketable debt and equity securities – at cost	4,695,887	4,732,349
Accounts receivable	419,572	581,311
Accrued interest receivable	64,071	57,606
Prepaid federal income taxes	—	96,392
Prepaid expenses	40,488	58,586
Prepaid state income taxes	18,744	40,783
Total current assets	<u>7,436,626</u>	<u>6,799,873</u>
Investments:		
Other investments	1,551,636	1,775,995
Marketable debt and equity securities – at cost	5,703,702	7,183,413
Land	234,939	234,939
Total investments	<u>7,490,277</u>	<u>9,194,347</u>
Total assets	<u>\$ 14,926,903</u>	<u>15,994,220</u>
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Accrued expenses	50,065	117,054
Deferred tax liability	612,715	1,232,000
Federal income taxes payable	36,420	—
Payroll taxes payable	27,956	33,326
Other liabilities	2,160	—
Total current liabilities	<u>729,316</u>	<u>1,382,380</u>
Stockholders' equity:		
Common stock, \$.001 par value – 20,000,000 shares authorized, 2,851,196 shares issued, 2,754,428 shares outstanding	47,520	47,520
Retained earnings	14,224,882	14,639,135
Total stockholders' equity	<u>14,272,402</u>	<u>14,686,655</u>
Less cost of treasury stock – 96,768 shares	<u>(74,815)</u>	<u>(74,815)</u>
Total liabilities and stockholders' equity	<u>\$ 14,926,903</u>	<u>15,994,220</u>

See accompanying notes to financial statements.

**BILOXI MARSH LANDS CORPORATION**  
Statements of Revenues and Expenses – Income Tax Basis  
Years ended December 31, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Revenues:		
Oil and gas		
Lease bonuses and delay rentals	\$ 335,900	314,121
Pipeline right of ways	5,000	25,000
Royalties (net of production taxes of \$217,856 and \$362,811 in 2007 and 2006, respectively)	4,520,363	8,323,295
Total oil and gas revenues	<u>4,861,263</u>	<u>8,662,416</u>
Other:		
Partnership income (loss)	(974,359)	169,659
Dividends and interest	521,942	790,481
Gain (loss) on sale of securities	208,600	(59,088)
Surface rentals	21,871	15,051
Total other revenues	<u>(221,946)</u>	<u>916,103</u>
Total revenues	<u>4,639,317</u>	<u>9,578,519</u>
Expenses:		
Salaries	162,000	102,000
Bonuses	265,800	244,200
Payroll taxes	15,191	12,679
Employee benefits	62,050	58,550
Association dues	6,600	6,600
Accounting and auditing	115,718	138,290
Severance tax preparation	4,207	9,131
Gas marketing fees	13,046	22,542
Clerical	—	80
Consultants	73,934	228,687
Depreciation	9,958	31,507
Directors' fees	72,000	99,250
Franchise taxes	74,050	82,899
Insurance	107,101	117,011
Land management fees	15,044	8,645
Legal fees	301,983	269,298
Other	73,070	95,842
Hurricane-related expenses	—	15,848
Portfolio services	30,124	32,358
Property taxes	18,031	36,922
Rent	11,231	13,500
Charitable contributions	1,000	14,256
Total expenses	<u>1,432,138</u>	<u>1,640,095</u>
Net income before income taxes	3,207,179	7,938,424
Income tax expense	867,004	2,386,825
Net income	<u>\$ 2,340,175</u>	<u>5,551,599</u>
Net income per share	<u>\$ 0.85</u>	<u>2.02</u>

See accompanying notes to financial statements.



**BILOXI MARSH LANDS CORPORATION**

Statement of Changes in Stockholders' Equity – Income Tax Basis

Years ended December 31, 2007 and 2006

	<u>Common stock</u>	<u>Treasury stock</u>	<u>Retained earnings</u>	<u>Total</u>
Balance, December 31, 2005, as previously reported	\$ 47,520	(74,815)	16,310,195	16,282,900
Cumulative adjustment for change in accounting method (note 1(b))	—	—	3,795,053	3,795,053
Balance, December 31, 2005 under new method of accounting	47,520	(74,815)	20,105,248	20,077,953
Net income	—	—	5,551,599	5,551,599
Distributions	—	—	(11,017,712)	(11,017,712)
Balance, December 31, 2006	47,520	(74,815)	14,639,135	14,611,840
Net income	—	—	2,340,175	2,340,175
Distributions	—	—	(2,754,428)	(2,754,428)
Balance, December 31, 2007	\$ <u>47,520</u>	<u>(74,815)</u>	<u>14,224,882</u>	<u>14,197,587</u>

See accompanying notes to financial statements.

**BILOXI MARSH LANDS CORPORATION**

Statements of Cash Flows – Income Tax Basis

Years ended December 31, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Cash flow provided by operating activities:		
Net income	\$ 2,340,175	5,551,599
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	9,958	31,507
Deferred income taxes	(619,285)	(616,000)
(Gain) loss on sale of securities	(208,600)	59,088
Change in operating assets and liabilities:		
Other assets	974,359	(169,659)
Accounts receivable	155,274	5,356,868
Prepaid expenses	18,098	55,386
Income taxes payable	154,851	(3,123,289)
Accrued expenses	(66,989)	(134,138)
Other liabilities	(3,210)	11,188
Net cash provided by operating activities	<u>2,754,631</u>	<u>7,022,550</u>
Cash flow provided by investing activities:		
Proceeds from maturing investments	22,780,040	49,198,784
Proceeds from the sale of securities	3,874,132	472,104
Investment in partnership	(750,000)	(1,606,335)
Purchase of securities	(24,929,399)	(46,350,339)
Purchase of office furniture and equipment	(9,958)	(31,507)
Net cash provided by investing activities	<u>964,815</u>	<u>1,682,707</u>
Cash flows from financing activities:		
Dividends paid	<u>(2,754,428)</u>	<u>(11,017,712)</u>
Net increase (decrease) in cash	965,018	(2,312,455)
Cash and cash equivalents, beginning of year	<u>1,232,846</u>	<u>3,545,301</u>
Cash and cash equivalents, end of year	\$ <u><u>2,197,864</u></u>	<u><u>1,232,846</u></u>

See accompanying notes to financial statements.

## BILOXI MARSH LANDS CORPORATION

### Notes to Financial Statements – Income Tax Basis

December 31, 2007 and 2006

#### (1) Summary of Significant Accounting Policies

##### (a) *Nature of Operations*

Biloxi Marsh Lands Corporation (the Corporation) has extensive land holdings in St. Bernard Parish, Louisiana, the vast majority of which are leased to exploration and production companies. A study by a reservoir engineering firm has estimated that the Corporation has proved reserves in natural gas associated with a portion of this property. These proved reserve estimates are not included in these financial statements.

The Corporation's principal source of income consists of rents, mineral royalties, and other income related to its real estate ownership. In addition, the Corporation has significant revenues from the investment of funds in marketable securities.

##### (b) *Basis of Accounting*

The accompanying financial statements have been prepared on the accrual method of tax accounting in accordance with Section 446(c) of the Internal Revenue Code. As such, the provision for income taxes and the income tax payable or refundable is computed based on the accrual method of tax accounting. The accompanying financial statements are not intended to present the financial position and results of operations of the Corporation in conformity with accounting principles generally accepted in the United States of America.

The Corporation had historically prepared its financial statements on the cash receipts and disbursements method of tax accounting. In order to achieve consistency in reporting, both the accompanying financial statements and the Corporation's tax returns will be prepared using the accrual method. Since 2005, the Corporation has been required to file its tax returns on the accrual method. The 2006 comparative financials have been restated in accordance with the accrual method for presentation. As a result of the change, 2006 previously reported net income of \$9,129,861 has been adjusted to \$5,551,599.

The Corporation's tax returns are subject to examination by federal taxing authorities. Because many types of transactions are susceptible to varying interpretations under federal income tax laws and regulations, the amount reported in the accompanying financial statements may be subject to change at a later date upon final determination by taxing authorities.

##### (c) *Cash And Cash Equivalents*

Cash and cash equivalents include cash on hand and amounts due from depository institutions.

##### (d) *Depreciation*

Depreciation of property is provided for in amounts sufficient to relate their cost over their estimated service lives using the Modified Accelerated Cost Recovery System (MACRS) rates as indicated for federal income tax purposes. Depreciation expense under U.S. generally accepted accounting principles is spread over the estimated useful lives of the assets using straight-line and some accelerated methods.

**BILOXI MARSH LANDS CORPORATION**

Notes to Financial Statements – Income Tax Basis

December 31, 2007 and 2006

In addition, assets totaling \$9,958 for 2007 and \$31,507 for 2006 were expensed in accordance with Section 179 of the Internal Revenue Code (IRC).

**(e) Other Investments**

During 2006, the Corporation invested in B&L Exploration, LLC (BLX). The Corporation accounts for its investment using the equity method. The Corporation's share of net income (loss) from BLX for 2007 and 2006 is \$(974,359) and \$169,659, respectively.

**(f) Net Income Per Share**

Net income per share is computed by dividing net income by the weighted average number of common shares outstanding during the period.

**(g) Use of Estimates**

The process of preparing financial statements requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues, and expenditures. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, upon settlement, actual results may differ from estimated amounts.

**(h) Reclassifications**

Certain reclassifications have been made to the prior period financial statements in order to conform to the classification adopted for reporting in fiscal 2007.

**BILOXI MARSH LANDS CORPORATION**

Notes to Financial Statements – Income Tax Basis

December 31, 2007 and 2006

**(2) Investments in Marketable Securities**

Marketable securities consist of investments in debt equity securities, which are carried at their amortized cost and equity securities, which are carried at cost. Cost, fair market value, and unrealized gains (losses) by security type at December 31, 2007 and 2006 are as follows:

	<u>Cost</u>	<u>Fair market value</u>	<u>Unrealized gains (losses)</u>
2007:			
Equity securities	\$ 3,521,832	5,151,533	1,629,701
Debt securities:			
Municipal bond	350,000	350,000	—
U.S. government agencies	<u>6,527,757</u>	<u>6,535,777</u>	<u>8,020</u>
	10,399,589	12,037,310	1,637,721
Less current portion	<u>(4,695,887)</u>	<u>(4,699,799)</u>	<u>(3,912)</u>
	<u>\$ 5,703,702</u>	<u>7,337,511</u>	<u>1,633,809</u>
2006:			
Equity securities	\$ 4,157,912	6,221,691	2,063,779
Debt securities:			
Municipal bond	1,400,000	1,400,000	—
U.S. government agencies	<u>6,357,850</u>	<u>6,365,441</u>	<u>7,591</u>
	11,915,762	13,987,132	2,071,370
Less current portion	<u>(4,732,349)</u>	<u>(4,759,533)</u>	<u>(27,184)</u>
	<u>\$ 7,183,413</u>	<u>9,227,599</u>	<u>2,044,186</u>

**(3) Income Taxes**

Components of income tax expense are as follows:

	<u>2007</u>	<u>2006</u>
Current:		
Federal	\$ 1,318,087	2,643,453
State	<u>168,202</u>	<u>359,372</u>
	<u>1,486,289</u>	<u>3,002,825</u>
Deferred:		
Federal	\$ (531,547)	(529,229)
State	<u>(87,738)</u>	<u>(86,771)</u>
	<u>(619,285)</u>	<u>(616,000)</u>
	<u>\$ 867,004</u>	<u>2,386,825</u>

## BILOXI MARSH LANDS CORPORATION

### Notes to Financial Statements – Income Tax Basis

December 31, 2007 and 2006

When the Corporation was required to change its accounting method from the cash receipts and disbursements method and file its tax returns on the accrual method in 2005, the Corporation was allowed to recognize a certain portion of income over a four-year period pursuant to Internal Revenue Code Section 481(a). The deferred benefit recognized above represents one fourth of the deferred taxes on the income deferral. Fiscal 2008 will be the fourth and final year of the income deferral for income tax purposes.

The reconciliation of U.S. federal statutory and effective income tax rates is shown below:

	<u>2007</u>	<u>2006</u>
Statutory rate	34.0%	34.0%
Percentage depletion	(7.6)	(5.6)
State taxes provided	1.7	2.3
Other (net)	(1.1)	(0.6)
Effective tax rate	<u>27.0%</u>	<u>30.1%</u>

#### (4) Related-Party Transactions

A member of the board of directors/officer is a partner in the law firm that represents the Corporation. Payments to this related party for the years ended December 31, 2007 and 2006 were \$43,803 and \$41,335, respectively.

#### (5) Dividends Declared

For the year ended December 31, 2007, cash dividends of \$1.00 per share were paid.

#### (6) Commitments and Contingencies

There is currently pending a Possessory action suit, which was filed by the Corporation on or about November 2, 2001 as a result of disturbances in the Corporation's possession of Sections 1, 2, and 3, T13S, and R16E due to competing oil, gas, and mineral leases granted to Manti Resources Inc. (Manti) by certain Manuel Molero family members and also to Louis and Gustave Carmadelle family entities. Further disturbances in the Corporation's possession are the result of competing seismic permit/lease options and competing leases granted by the same parties to The Meridian Resource & Exploration LLC (Meridian) for acreage outside of the Manti lease. The Manuel Molero family members have filed a Declaratory Judgment action against the Corporation and the Louis and Gustave Carmadelle family entities with regard to the same acreage, which action has been consolidated with the Possessory action. On or about July 20, 2006, the Carmadelle entities filed an additional Declaratory Judgment lawsuit with regard to the same acreage. In addition to the above-described competing claims to the subject acreage, there are also competing claims between the Corporation and the State of Louisiana regarding certain waterbottoms within each producing unit on the acreage in question. As a result of the competing claims and above-mentioned actions, both Manti and Meridian have filed concursus proceedings whereby royalties attributable to all of the conflicting acreage are deposited into the registry of the court. There is no potential for an adverse judgment declaring the payment of Corporation funds as the consolidated suits will ultimately determine the possession and ownership of the subject property and the right to the proceeds from production on deposit. The Corporation has no liability beyond the costs of defending and

## **BILOXI MARSH LANDS CORPORATION**

Notes to Financial Statements – Income Tax Basis

December 31, 2007 and 2006

prosecuting the various lawsuits and concursus proceedings. As of December 31, 2007, the Corporation's potential share of the funds deposited in the various concursus accounts is approximately \$48 million. The effects of Hurricane Katrina have substantially impacted the aforementioned litigation due to severe damages to the courthouse in St. Bernard Parish. Therefore, as of the date of this report, there is no way to forecast a timetable for the conclusion of the litigation and the resolution of the disputes, nor can the Corporation, at this time, predict the outcome of the litigation.

### **(7) Uninsured Cash Balances**

The Corporation maintains cash and cash equivalents with local highly rated financial institutions. The cash balances are guaranteed by the Federal Deposit Insurance Corporation (FDIC) up to \$100,000 per bank. The Corporation had uninsured cash balances at December 31, 2007 and 2006 of \$1,753,785 and \$451,627, respectively.

## BILOXI MARSH LANDS CORPORATION

## Schedule of Marketable Securities

December 31, 2007 and 2006

Company Description	2007				2006			
	Shares/ face value	Cost	Market value	Unrealized gains (losses)	Shares/ face value	Cost	Market value	Unrealized gains (losses)
Marketable equity securities:								
Common stock:								
3 D Systems Corp.	23,000	\$ 282,042	355,120	73,078	19,000	\$ 222,367	303,240	80,873
AAR Corp.	12,200	337,787	463,966	126,179	—	—	—	—
Advanced Med Optics Inc.	—	—	—	—	8,200	280,080	288,640	8,560
American Vanguard Corp.	20,800	116,690	360,880	244,190	20,800	116,690	330,720	214,030
Block, H&R, Inc.	—	—	—	—	12,700	307,780	292,608	(15,172)
Cabelas's Inc. - Class A	13,000	315,667	195,910	(119,757)	—	—	—	—
Cabot Corp.	—	—	—	—	8,000	279,745	348,560	68,815
Digital Insight	—	—	—	—	13,700	341,718	527,313	185,595
EPIQ Systems Inc.	18,000	208,659	313,380	104,721	16,400	272,679	278,308	5,629
First State Bancorporation	14,000	211,687	194,600	(17,087)	14,000	211,687	346,500	134,813
Gulf Island Fabrication Inc.	9,000	284,372	285,390	1,018	—	—	—	—
Input Output Inc.	—	—	—	—	30,000	239,152	408,900	169,748
Ion Geophysical Corp.	26,500	211,251	418,170	206,919	—	—	—	—
Jack Henry & Associates	14,000	68,442	340,760	272,318	14,000	68,442	299,600	231,158
Luminex Corp.	34,000	231,313	552,160	320,847	34,000	231,313	431,800	200,487
Marcus Corporation	13,500	222,170	208,575	(13,595)	13,500	222,170	345,330	123,160
Noble International Ltd.	18,000	289,054	293,580	4,526	18,000	289,054	360,900	71,846
O' Reilly Automotive Inc.	10,400	199,077	337,272	138,195	10,400	199,077	333,424	134,347
PHI Inc.	9,500	208,727	300,200	91,473	9,500	208,727	313,500	104,773
Quest Diagnostic, Inc.	6,300	316,562	333,270	16,708	6,300	316,562	333,900	17,338
SCP Pool Corp.	10,000	18,332	198,300	179,968	10,000	18,332	391,700	373,368
YRC Worldwide Inc.	—	—	—	—	7,600	332,337	286,748	(45,589)
Subtotal		3,521,832	5,151,533	1,629,701		4,157,912	6,221,691	2,063,779
Marketable debt securities:								
Municipal Bonds:								
Jefferson Cnty Ala Svr Rev Arts Ref-wts-subser	—	—	—	—	450,000	450,000	450,000	—
B-1-C, due February 1, 2042	—	—	—	—	—	—	—	—
Louisiana Loc Govt envr Facs-S-Eastern LA	350,000	350,000	350,000	—	350,000	350,000	350,000	—
Stud, due August 1, 2034	—	—	—	—	—	—	—	—
Sevier Cnty Tenn Pub Bldg Auth Var-Loc	—	—	—	—	600,000	600,000	600,000	—
Govt Pub Impt, due October 1, 2025	—	—	—	—	—	—	—	—
Subtotal		350,000	350,000	—		1,400,000	1,400,000	—
U.S. government agencies:								
Federal Home Loan Discount Note, due January 10, 2007	—	—	—	—	1,000,000	987,500	998,287	10,787
Federal Home Loan Discount Note, due January 25, 2007	—	—	—	—	1,000,000	992,004	996,154	4,150
Federal Home Loan Discount Note, due February 14, 2007	—	—	—	—	1,089,000	1,070,094	1,081,726	11,632
Federal Home Loan Discount Note, due March 16, 2007	—	—	—	—	1,450,000	1,432,813	1,434,193	1,380



## BILOXI MARSH LANDS CORPORATION

## Schedule of Marketable Securities

December 31, 2007 and 2006

Company Description	2007				2006			
	Shares/ face value	Cost	Market value	Unrealized gains (losses)	Shares/ face value	Cost	Market value	Unrealized gains (losses)
Federal Home Loan Bank Note, due February 28, 2007 4.270%	—	\$ —	—	—	200,000	\$ 199,938	199,688	(250)
Federal Home Loan Bank Note, due September 26, 2007 3.800%	—	—	—	—	50,000	50,000	49,485	(515)
Federal Home Loan Bank Note, due February 28, 2008 4.530%	245,000	244,923	244,924	1	245,000	244,923	243,087	(1,836)
Federal Home Loan Bank Note, due April 14, 2008, 3.750%	200,000	200,000	199,500	(500)	200,000	200,000	196,562	(3,438)
Federal Home Loan Bank Note, due August 8, 2008 4.500%	250,000	249,375	250,235	860	250,000	249,375	247,812	(1,563)
Federal Home Loan Bank Note, due September 16, 2009, 4.110%	100,000	99,875	100,000	125	100,000	99,875	97,656	(2,219)
Federal Home Loan Bank Note, due October 13, 2009, 4.100%	200,000	200,000	200,000	—	200,000	200,000	195,126	(4,874)
Federal Home Loan Bank Note, due December 9, 2009, 4.375%	135,000	135,000	135,000	—	135,000	135,000	132,385	(2,615)
Federal Home Loan Bank Note, due July 14, 2010 4.800%	500,000	496,328	500,000	3,672	500,000	496,328	493,280	(3,048)
Federal Home Loan Bank Note, due January 15, 2008 5.200%	1,000,000	1,000,000	1,000,310	310	—	—	—	—
Federal Home Loan Bank Note, due February 4, 2008 5.200%	775,000	775,000	775,488	488	—	—	—	—
Federal Home Loan Discount Note, due March 24, 2008	2,706,000	2,675,964	2,679,077	3,113	—	—	—	—
Federal Home Loan Discount Note, due April 15, 2008	457,000	451,292	451,243	(49)	—	—	—	—
Subtotal		6,527,757	6,535,777	8,020		6,357,850	6,365,441	7,591
Total investments as of December 31, 2006 and 2005		\$ 10,399,589	12,037,310	1,637,721		\$ 11,915,762	13,987,132	2,071,370

See accompanying independent auditors' report.