

# **Biloxi Marsh Lands Corporation**

**One Galleria Blvd., Suite #902**

**Metairie, Louisiana 70001**

**Phone: (504) 837-4337**

**Fax: (504) 837-1889**

March 19, 2012

To the Shareholders of Biloxi Marsh Lands Corporation:

The following is a discussion of the results of operations of the Company for the year ended December 31, 2011. The annual revenue breakdown is as follows: 2011 revenue from oil and gas activity for the Company's fee lands was \$1,503,056 compared to revenue of \$7,030,933 in 2010. During 2010, the Company received \$5,205,463 in nonrecurring oil and gas revenue which was the result of the settlement of all cases involving disputed ownership of water-bottoms between the Company and the State of Louisiana.

During 2011, total revenues included a \$3,423,042 loss emanating from the Company's investment in B&L Exploration, LLC (B&L). This compares to a loss of \$764,018 from B&L in the prior year. As an operating oil and gas entity, B&L's results included deductions for depreciation, depletion and amortization (DD&A) costs relating to its ongoing drilling and production activities. BLMC's share of these DD&A expenses was \$1,801,797 and \$733,934 for 2011 and 2010, respectively. While the Company had the option to capitalize its portion of intangible drilling costs (IDC) incurred by B&L in its 2010 and 2011 drilling programs, the Company elected to expense one hundred percent (100%) of its share of IDC for the years 2010 and 2011. By fully expensing its portion of B&L's IDC for calendar year 2011, the Company is able to carry back the current year generated loss to prior years and obtain significant refunds of income taxes paid in 2008 and 2009. During 2012, the Company will file carryback claims which will likely result in income tax refunds totaling \$742,136.

Meanwhile, dividend and interest income for 2011 was \$254,128 compared to \$327,475 for 2010. In 2011, we realized a cumulative gain from the sale of investment securities of \$1,600,569 compared to a cumulative gain in the amount of \$218,149 in 2010. Expenses for the year totaled \$1,439,114 compared to \$1,649,451 for the prior year. For the year, the Company incurred a net loss of \$695,955 or \$0.25 per share compared to a net profit of \$3,934,262 or \$1.44 per share in 2010. It should be noted that the Company's basis of accounting is the accrual method of tax accounting used for federal income tax purposes.

As of December 31, 2011 the combined gross daily production rate from 6 wells operated by the Company's mineral Lessees was approximately 6.9 million cubic feet (mmcf) of natural gas with net daily production accruing to the Company of approximately .894 mmcf. As of December 31, 2011, B&L's net daily production was approximately 4.0 million cubic feet of natural gas equivalents (mmcfge) (15:1 oil to gas ratio) compared to approximately 3.0 mmcfge per day as of December 31, 2010. Combining this daily production with the Company's proportional share of the daily production from the B&L wells makes the total net daily production accruing to the Company as of December 31, 2011 approximately 4.3 mmcf per day compared to 4.02 mmcfge as of December 31, 2010. This increased daily production was due solely to the increase in B&L's daily production. It should be noted that B&L has a non-operated working interest in three wells which have been drilled, completed and successfully flow tested, but are yet to be placed on production. All three of these wells, SL 19706 No. 1, CL&F No.1, and the Goodrich Land and Energy No. 1 are expected to be placed on production during the first half of 2012.

In February of 2012 the Goodrich Land and Energy No. 1 well located in St. Martin Parish, Louisiana and operated by Linder Oil Company was drilled, successfully completed and partially flow tested. Electric logs indicated approximately 47 net feet of pay in four sand intervals. The lowest interval, the "J" Sand, was successfully flow tested at a maximum rate of 849 mcf per day with flowing tubing pressure of 3,135 psi on a 10/64<sup>th</sup> choke. Based on production history in the field, the Operator anticipates that this "J" sand zone should turn to oil after the natural gas cap is produced. Linder Oil Company advises this well should be

placed on production by April 30, 2012. B&L has as 15% non-operated working interest in this well.

Meanwhile, the SL 19706 No. 1 Well operated by Clayton Williams Energy (CWE) and in which B&L has a 15% non-operated working interest is scheduled to be placed on production by April 15, 2012. This well was originally scheduled to be placed on production as of January 1, 2012 but has been delayed due to weather and problems in constructing the sales pipeline tie-in.

The CL&F No. 1 Well which was flow tested on September 27, 2011 and operated by Forza Operating Company is scheduled to be placed on production by June 15, 2012. B&L has a 9.375% non-operated working interest in this well.

The Company commissioned T. J. Smith & Company, Inc., independent reservoir engineers, to complete a proved reserve study. This reserve study estimates that as of December 31, 2011 BLMC's "Developed Producing" (PDP) reserves were .600 billion cubic feet (BCF) of natural gas and estimates that the "Developed Non-Producing" (PDNP) reserves were .521 BCF, totaling 1.121 BCF of estimated proved natural gas reserves. Additionally, this reserve study estimates that slightly more than 21% of the proved reserves will deplete by the end of 2012.

Please find the following table showing the Company's proved reserves as of December 31, 2011:

**Proved Reserves as of December 31, 2011 (3)**

	<u>Developed Producing (PDP)</u>	<u>Developed Non-Producing (PDNP)</u>	<u>Total</u>
	(Dollars in thousands)		
Net Proved Reserves (1):			
Natural Gas (BCF):	.600	.521	1.121
Estimated Future Net Revenues (before income taxes) (2):.....		\$	4,410 (4)
Estimated Discounted Future Net Revenues (before income taxes) (2):.....		\$	3,223 (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. 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 12 month average price calculated as the unweighted arithmetic average of the first-day-of-the-month price for each month within the 12 month period prior. 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 o 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 base product price based on the 12 month average price calculated as the unweighted arithmetic average of the first-day-of-the-month price for each month within the 12 month period prior to December 31, 2011. The oil price of \$96.19 per barrel is based on the West Texas Intermediate (WTI), Cushing, Oklahoma spot prices. The natural gas price of \$4.118 per MMBtu is based on the Henry Hub gas daily prices.

(3) The Meridian Resource and Exploration, LLC (now owned by Alta Mesa Holdings, LP) 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.

Additionally, T.J. Smith & Company, Inc. completed a separate proved reserve study that estimates that B&L's reserves were 2.4 billion cubic feet (BCF) of natural gas and 81 thousand barrels of oil (MBBL) as of December 31, 2011. The estimated gross value of these proved reserves was \$18.2mm. This gross value net of operating expenses, severance taxes, ad valorem taxes, future capital and other costs equates to "Estimated Future Net Revenues" of \$13.15mm with an "Estimated Discounted Future Net Revenues" of \$9.98mm (see note 2 above) compared to 2.3 BCF and 25 thousand barrels of oil (MBBL) at the end of 2010. B&L maintains a line of credit with Whitney Bank in the amount of \$5mm and is partially guaranteed by the Company. During 2011, the line of credit was not utilized.

On October 1, 2008 we announced our plans to repurchase up to 27,500 shares of our common stock. On September 13, 2011, we authorized the purchase of an additional 13,000 shares of our common stock. As of December 31, 2011 we have been successful in purchasing a total of 19,100 shares of common stock. As of this time, we plan to continue to repurchase our common stock until we fulfill our goal of acquiring 40,500 shares.

B&L was organized as a limited liability Company (LLC) under the laws of Louisiana in July of 2006. B&L's Class A members are BLMC and Lake Eugenie Land & Development, Inc. (LKEU), which have membership percentages of 75% and 25%, respectively. The Operating Agreement was amended on November 16, 2009 to create a Class B membership to allow for certain future projects at the discretion of the board of managers to be participated by either Class A or Class B members or a combination of the respective Classes. B&L's Class B members are BLMC and LKEU, which have membership percentages of 90% and 10%, respectfully.

During its meeting held on December 6, 2011, the Board of Directors declared a \$0.55 per share dividend payable on Wednesday, December 28, 2011 to shareholders of record as of the close of business on Wednesday, December 14, 2011. This represents a total cash dividend payment of \$1,505,420 or \$0.55 per share. Since 2002, the Company has paid slightly more than \$51,500,000 in total dividends. With our fee land based production depleting and no new wells being drilled on our fee lands, it will be difficult to maintain the level of dividends paid since 2002. With this said, using 3D seismic data in our possession, we are constantly working on developing the minerals located below our fee lands. Meanwhile, we are focusing on developing reserves outside of our fee acreage position through our investment in B&L. In its current stage of growth and continued reinvestment in its successful drilling program, B&L should not be viewed as a dividend producing entity.

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).

While the Company has proved reserves assigned to its fee acreage which represent continued significant value, there were no new wells drilled on the Company's acreage during 2011. Our planned filing of carryback claims that will likely result in income tax refunds totaling \$742,136 is a significant strategic financial move. We will continue to work on developing both shallow and deep prospects on the Company's property, particularly our deep Tuscaloosa Project. With this said, the current depressed price of natural gas is making the marketing of these prospects difficult. Conversely, recent apparent discoveries and continued exploration in ultra-deep natural gas by McMoRan Exploration and others will advance deep drilling and completion technology. If and when natural gas prices rebound, the Company's acreage should become more attractive and we are positioned to take advantage of the changes in market pricing.

Meanwhile, we continue to be pleased with the results of B&L's drilling program. B&L exceeded the five million dollar revenue threshold for the first time since its inception and placed two new wells on production during 2011 with three additional wells awaiting the day of first production sales. As of December 31, 2011, B&L had working interests in nine wells to which proved reserves were assigned representing a gross value of

over \$18mm (see explanation above). B&L plans to continue its drilling program and currently has two additional wells scheduled to be drilled during 2012 and is evaluating additional prospects. Due to the large variance in price between oil and natural gas, B&L is focusing on oil prospects and natural gas prospects with potentially high natural gas liquid yields.

2012 will be a challenging year, but we are positioning the Company for the future and look forward to the challenge.

Sincerely,

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

---

<sup>i</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 and Schedule – Income Tax Basis  
December 31, 2011 and 2010  
(With Independent Auditors' Report Thereon)

# BILOXI MARSH LANDS CORPORATION

## Table of Contents

	<b>Page</b>
Independent Auditors' Report	1
Statements of Assets, Liabilities, and Stockholders' Equity – Income Tax Basis	3
Statements of Revenues and Expenses – Income Tax Basis	4
Statements of Changes in Stockholders' Equity – Income Tax Basis	5
Statements of Cash Flows – Income Tax Basis	6
Notes to Financial Statements – Income Tax Basis	7
<b>Schedule</b>	
Schedule of Marketable Securities – December 31, 2011 and 2010	14



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

## Independent Auditors' Report

The 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 Company) as of December 31, 2011 and 2010, 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 – income tax basis are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements – income tax basis 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 – income tax basis 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 Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements – income tax basis. 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.

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

Because many types of transactions are susceptible to varying interpretations under federal and state income tax laws and regulations, the amounts reported in the accompanying financial statements – income tax basis may be subject to change at a later date upon final determination by the taxing authorities.

In our opinion, the financial statements – income tax basis referred to above present fairly, in all material respects, the assets, liabilities, and stockholders' equity of Biloxi Marsh Lands Corporation as of December 31, 2011 and 2010, and its revenues and expenses, changes in its stockholders' equity, and its cash flows for the years then ended, on the basis of accounting described in note 1(b).

Our audits were conducted for the purpose of forming an opinion on the financial statements – income tax basis as a whole. The supplementary information included in Schedule 1 is presented for purposes of additional analysis and is not a required part of the financial statements – income tax basis. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements – income tax basis. The information has been subjected to the auditing procedures applied in the audits of the financial statements – income tax basis and certain additional procedures, including comparing and reconciling such information



directly to the underlying accounting and other records used to prepare the financial statements – income tax basis or to the financial statements – income tax basis themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements – income tax basis as a whole.

KPMG LLP

New Orleans, Louisiana  
March 5, 2012



**BILOXI MARSH LANDS CORPORATION**

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

December 31, 2011 and 2010

<b>Assets</b>	<b>2011</b>	<b>2010</b>
Current assets:		
Cash and cash equivalents	\$ 3,220,432	4,470,636
Accounts receivable	146,516	207,286
Settlement funds receivable	—	1,730,389
Accrued interest receivable	22,250	38,893
Prepaid expenses	39,987	39,144
Due from related party	—	27,647
Deferred tax asset	813,807	—
Federal income taxes receivable	16,136	—
State income taxes receivable	14,160	—
Marketable debt securities – at cost	301,525	—
Other assets	3,830	3,830
Total current assets	<u>4,578,643</u>	<u>6,517,825</u>
Investment in partnership	1,335,857	4,758,899
Marketable debt and equity securities – at cost	10,028,136	8,043,450
Land	234,939	234,939
Levees and office furniture and equipment	298,429	277,679
Accumulated depreciation	<u>(298,429)</u>	<u>(277,679)</u>
Total assets	<u>\$ 16,177,575</u>	<u>19,555,113</u>
<b>Liabilities and Stockholders' Equity</b>		
Current liabilities:		
Income taxes payable	\$ —	1,088,754
Accrued expenses	19,345	44,856
Other current liabilities	4,410	3,960
Total current liabilities	<u>23,755</u>	<u>1,137,570</u>
Stockholders' equity:		
Common stock, \$0.001 par value. Authorized, 20,000,000 shares; issued, 2,851,196 shares; outstanding, 2,735,328 and 2,741,428 shares in 2011 and 2010, respectively	47,520	47,520
Retained earnings	16,351,713	18,553,088
Treasury stock, 115,868 and 109,768 shares in 2011 and 2010, respectively, at cost	<u>(245,413)</u>	<u>(183,065)</u>
Total stockholders' equity	<u>16,153,820</u>	<u>18,417,543</u>
Total liabilities and stockholders' equity	<u>\$ 16,177,575</u>	<u>19,555,113</u>

See accompanying notes to financial statements – income tax basis.

**BILOXI MARSH LANDS CORPORATION**

Statements of Revenues and Expenses – Income Tax Basis

Years ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Revenues:		
Oil and gas royalties	\$ 1,519,192	1,833,661
Oil and gas royalties settlement	—	5,205,463
Severance taxes	<u>(66,136)</u>	<u>(88,191)</u>
Oil and gas royalties, net	1,453,056	6,950,933
Surface rentals	<u>50,000</u>	<u>80,000</u>
Total oil and gas revenues	<u>1,503,056</u>	<u>7,030,933</u>
Other (loss) income:		
Loss from investment in partnership	(3,423,042)	(764,018)
Dividends and interest income	254,128	327,475
Gain on sale of securities	1,600,569	218,149
Surface rentals	22,145	18,714
Other	<u>43,642</u>	<u>238,656</u>
Total other (loss) income	<u>(1,502,558)</u>	<u>38,976</u>
Total revenues and income	<u>498</u>	<u>7,069,909</u>
Expenses:		
Salaries	204,000	202,000
Bonuses	240,000	287,500
Payroll taxes	16,866	16,350
Employee benefits	33,187	71,353
Association dues	850	6,650
Accounting and auditing	121,076	93,094
Gas marketing fees	8,512	8,889
Consultants	91,872	116,236
Depreciation	20,750	26,347
Directors' fees	157,750	178,500
Franchise taxes	119,004	130,900
Insurance	102,744	96,994
Land management fees	26,804	14,212
Legal fees	59,588	212,948
Other	115,469	82,715
Portfolio services	68,709	59,121
Property taxes	17,341	17,139
Rent	33,092	28,503
Charitable contributions	<u>1,500</u>	<u>—</u>
Total expenses	<u>1,439,114</u>	<u>1,649,451</u>
Net (loss) income before income taxes	(1,438,616)	5,420,458
Income tax (benefit) expense	<u>(742,661)</u>	<u>1,486,196</u>
Net (loss) income	\$ <u>(695,955)</u>	<u>3,934,262</u>
Net (loss) income per share	\$ (0.25)	1.44

See accompanying notes to financial statements – income tax basis.

**BILOXI MARSH LANDS CORPORATION**

Statements of Changes in Stockholders' Equity – Income Tax Basis

Years ended December 31, 2011 and 2010

	Common stock		Treasury stock		Retained earnings	Total
	Shares	Amount	Shares	Amount		
Balance, December 31, 2009	2,851,196	\$ 47,520	(109,768)	\$ (183,065)	18,045,611	17,910,066
Net income	—	—	—	—	3,934,262	3,934,262
Dividends	—	—	—	—	(3,426,785)	(3,426,785)
Balance, December 31, 2010	2,851,196	47,520	(109,768)	(183,065)	18,553,088	18,417,543
Net loss	—	—	—	—	(695,955)	(695,955)
Purchase of treasury shares	—	—	(6,100)	(62,348)	—	(62,348)
Dividends	—	—	—	—	(1,505,420)	(1,505,420)
Balance, December 31, 2011	2,851,196	\$ 47,520	(115,868)	\$ (245,413)	16,351,713	16,153,820

See accompanying notes to financial statements – income tax basis.

**BILOXI MARSH LANDS CORPORATION**

Statements of Cash Flows – Income Tax Basis

Years ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Cash flows provided by operating activities:		
Net (loss) income	\$ (695,955)	3,934,262
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation	20,750	26,347
Gain on sale of securities	(1,600,569)	(218,149)
Loss from investment in partnership	3,423,042	764,018
Change in operating assets and liabilities:		
Accounts and interest receivables	1,807,802	(1,758,001)
Due from related party	27,647	(27,647)
Prepaid expenses	(843)	(1,817)
Deferred income taxes	(813,807)	—
Income taxes receivables and payables	(1,119,050)	1,414,475
Accrued expenses	(25,511)	23,109
Payroll taxes and other liabilities	450	1,441
Net cash provided by operating activities	<u>1,023,956</u>	<u>4,158,038</u>
Cash flows from investing activities:		
Proceeds from the sale of securities	6,669,810	2,575,631
Purchase of securities	(7,355,452)	(2,721,128)
Purchase of office furniture and equipment	(20,750)	(26,347)
Investment in partnership	—	(2,700,000)
Net cash used in investing activities	<u>(706,392)</u>	<u>(2,871,844)</u>
Cash flows from financing activities:		
Treasury stock purchased	(62,348)	—
Dividends paid	(1,505,420)	(3,426,785)
Net cash used in financing activities	<u>(1,567,768)</u>	<u>(3,426,785)</u>
Net decrease in cash and cash equivalents	(1,250,204)	(2,140,591)
Cash and cash equivalents, beginning of year	<u>4,470,636</u>	<u>6,611,227</u>
Cash and cash equivalents, end of year	\$ <u><u>3,220,432</u></u>	\$ <u><u>4,470,636</u></u>
Supplemental cash flow information:		
Cash paid for income taxes	\$ 1,190,196	71,721

See accompanying notes to financial statements – income tax basis.

## BILOXI MARSH LANDS CORPORATION

Notes to Financial Statements – Income Tax Basis

December 31, 2011 and 2010

### (1) Summary of Significant Accounting Policies

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

Biloxi Marsh Lands Corporation (the Company) is a Delaware corporation whose principal assets are surface and mineral rights to approximately 90,000 acres of marsh land in St. Bernard Parish, Louisiana, which generates revenues primarily from mineral activities including lease bonuses, delay rentals, and royalties on oil and natural gas production. A study by an independent reservoir engineering firm estimates that the Company has proved reserves in natural gas associated with a portion of this property. These proved reserve estimates are not included in these financial statements – income tax basis.

As discussed in note 3, the Company owns an interest in B&L Exploration L.L.C. (B&L). B&L is engaged principally in the exploration for and development of oil and natural gas resources through various ownership interests in oil and natural gas properties located in the state of Louisiana.

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

The accompanying financial statements are presented in accordance with the accrual method of tax accounting used for federal income tax reporting purposes. Under this method of accounting, revenues are generally recorded when earned, and expenses are recognized when incurred. The accompanying financial statements – income tax basis are not intended to present the financial position and results of operation of the Company in conformity with accounting principles generally accepted in the United States of America.

Because many types of transactions are susceptible to varying interpretations under federal and state income tax laws and regulations, the amounts reported in the financial statements – income tax basis may be subject to change at a later date upon final determination by the taxing authorities.

#### (c) *Use of Estimates*

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

#### (d) *Cash and Cash Equivalents*

The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. Cash and cash equivalents include \$2,435,913 and \$3,543,271 of money market funds with an initial term of less than three months at December 31, 2011 and 2010, respectively.

#### (e) *Accounts Receivable*

Accounts receivable are recorded at invoiced amount and do not bear interest. Amounts collected on accounts receivable are included in net cash provided by operating activities in the statements of cash flows – income tax basis. Account balances are charged off after all means of collection have been

## BILOXI MARSH LANDS CORPORATION

### Notes to Financial Statements – Income Tax Basis

December 31, 2011 and 2010

exhausted and the potential for recovery is remote. The Company does not have any off-balance-sheet exposure related to its customers.

**(f) Investment Securities**

Investment securities at December 31, 2011 and 2010 consist of corporate debt and equity securities. The Company has the ability and intent to hold its investments in corporate bonds until maturity. The Company's investments in equity securities are available for sale. The Company does not buy and hold investment securities principally for the purpose of selling them in the near term.

Under the income tax basis of accounting, investment securities are recorded at cost in the statements of assets, liabilities, and stockholders' equity – income tax basis. Unrealized gains and losses are excluded from earnings until realized. Realized gains and losses from the sale of equity securities are determined on a specific-identification basis. Dividend income is recognized when received. Interest income is recognized when earned.

**(g) Land and Equipment**

Land and equipment are stated at cost. The Company had depreciation expense of \$20,750 and \$26,347 in 2011 and 2010, respectively. Repair and maintenance costs are expensed when incurred.

Depreciation of property is provided for in amounts sufficient to recognize their cost over their estimated service lives using the Modified Accelerated Cost Recovery System (MACRS) rates as indicated for federal income tax purposes. Assets purchased totaling \$20,750 and \$26,347 in 2011 and 2010, respectively, were depreciated in full in the year the asset was put in service in accordance with the Internal Revenue Code (IRC) provisions.

**(h) Revenue Recognition**

Under the accrual method of tax accounting, the Company recognizes revenue in the period in which all events have occurred that fix the right to receive the revenue, and the amount can be determined with reasonable accuracy. Severance tax is remitted to the State of Louisiana and is reported as a reduction of oil and natural gas royalties in the statements of revenues and expenses – income tax basis.

**(i) Treasury Stock**

The Company follows the cost method of accounting for treasury stock transactions.

**(j) Income Taxes**

Under the income tax basis of accounting, income taxes are accounted for based on an estimate of current federal and state income tax expense. Income tax expense includes federal and state taxes currently payable as well as deferred taxes.

Operating loss and tax credit carryforwards are recognized as reductions to net deferred income tax liabilities, if it is likely that their benefit will be realized. 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

**BILOXI MARSH LANDS CORPORATION**

Notes to Financial Statements – Income Tax Basis

December 31, 2011 and 2010

liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Under the income tax basis of accounting, the Company does not recognize a liability for uncertain tax positions until agreement and settlement is reached with the taxing authority.

**(k) Net Income per Share**

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

**(l) Commitments and Contingencies**

Under the income tax basis of accounting, liabilities for loss contingencies, including environmental remediation costs, arising from claims, assessments, litigation, fines, and penalties and other sources, are not recorded until paid. Commitments and contingencies, if material, are disclosed even if not paid as of the financial reporting date

**(m) Reclassifications**

Certain amounts in the accompanying 2010 financial statements have been reclassified to conform to 2011 presentation.

**(2) Investments in Investment Securities**

The cost basis, unrecorded gross unrealized gains, unrecorded gross unrealized losses, and fair value of corporate bonds and equity securities as of December 31, 2011 and 2010 were as follows:

	<u>Cost basis</u>	<u>Gross unrealized gains</u>	<u>Gross unrealized losses</u>	<u>Fair value</u>
At December 31, 2011:				
Corporate bonds	\$ 1,763,627	154,496	—	1,918,123
Equity securities	8,566,034	1,342,024	(236,170)	9,671,888
	<u>\$ 10,329,661</u>	<u>1,496,520</u>	<u>(236,170)</u>	<u>11,590,011</u>
At December 31, 2010:				
Corporate bonds	\$ 3,130,215	241,615	—	3,371,830
Equity securities	4,913,235	1,836,285	—	6,749,520
	<u>\$ 8,043,450</u>	<u>2,077,900</u>	<u>—</u>	<u>10,121,350</u>

**BILOXI MARSH LANDS CORPORATION**

Notes to Financial Statements – Income Tax Basis

December 31, 2011 and 2010

Maturities of corporate bonds were as follows at December 31, 2011:

	<u>Cost basis</u>	<u>Fair value</u>
Due within one year	\$ 301,525	310,489
Due after one through five years	1,196,587	1,303,104
Due after five years through ten years	<u>265,515</u>	<u>304,530</u>
	<u>\$ 1,763,627</u>	<u>1,918,123</u>

Cash proceeds from the sale of investment securities were \$6,669,810 and \$2,575,631 in 2011 and 2010, respectively. Realized cash gains from the sale of investment securities were \$1,600,569 and \$218,149 in 2011 and 2010, respectively. The Company had no investment securities with other-than-temporary declines in fair value at December 31, 2011.

**(3) Investment in Partnership**

The Company owns an interest in B&L an oil and gas exploration business. According to the operating agreement dated August 23, 2006, the Company owns a 75% interest in Class A membership of B&L. The remaining 25% interest in B&L is owned by Lake Eugenie Land & Development, Inc., a related party of the Company. B&L has commissioned a reserve study, which was completed by an independent reservoir engineering firm. This reserve study estimates that B&L has proved reserves in natural gas and oil attributable to its mineral properties. The proved reserve estimates are not included in the table below summarizing financial information – income tax basis of B&L. The operating agreement was amended on November 16, 2009 to create a Class B membership to allow for certain future projects at the discretion of the board of managers to be participated by members of either Class A, Class B, or a combination of the respective Classes. The Company owns a 90% interest in Class B membership of B&L. The remaining 10% of Class B membership percentage is owned by Lake Eugenie Land & Development, Inc.

Under the income tax method of accounting, the Company accounts for its membership percentage on the equity method whereby the Company recognizes its share of income and losses of the investment. The Company recognized \$3,423,042 and \$764,018 of losses in 2011 and 2010, respectively.



**BILOXI MARSH LANDS CORPORATION**

Notes to Financial Statements – Income Tax Basis

December 31, 2011 and 2010

The carrying amount of the investment in B&L was \$1,335,857 and \$4,758,899 at December 31, 2011 and 2010, respectively. Summary financial information – income tax basis of B&L as of and for the years ended December 31, 2011 and 2010 (on the income tax basis of accounting) is as follows:

	<u>2011</u>	<u>2010</u>
Financial position – income tax basis:		
Current assets	\$ 2,729,077	4,460,120
Mineral properties and equipment, net	1,795,987	1,854,968
Total assets	<u>\$ 4,525,064</u>	<u>6,315,088</u>
Current liabilities	\$ 2,869,442	910,054
Total current liabilities	2,869,442	910,054
Members' equity	1,655,622	5,405,034
Total liabilities and members' equity	<u>\$ 4,525,064</u>	<u>6,315,088</u>
Results of operations – income tax basis:		
Revenues, net	\$ 5,081,717	4,401,700
Net loss	(3,749,412)	(687,774)

The Company has provided a guarantee of a \$5,000,000 revolving line of credit with a bank held by B&L. The guarantee is allocated to the members based upon membership Class percentage, which can be identified to certain projects for which the borrowings were utilized. As of December 31, 2011, the Company's guarantee is 75% of \$5,000,000, or \$3,750,000, which is consistent with its Class A membership percentage, as all borrowings are identified with Class A membership projects. The line of credit expires November 1, 2012. Outstanding borrowings by B&L under the revolving line of credit were \$0 as of December 31, 2011 and 2010, respectively. Under the income tax basis of accounting, the estimated fair value of the Company's guarantee of B&L's revolving line of credit is not required to be recognized. As of December 31, 2011, there are no indications that the Company will be required to perform under the terms of the guarantee.

**(4) Income Taxes**

Components of income tax expense (benefit) are as follows:

	2011			2010		
	<u>Current</u>	<u>Deferred</u>	<u>Total</u>	<u>Current</u>	<u>Deferred</u>	<u>Total</u>
Federal	\$ 71,146	(642,105)	(570,959)	1,327,636	—	1,327,636
State	—	(171,702)	(171,702)	158,560	—	158,560
Total income tax expense (benefit)	<u>\$ 71,146</u>	<u>(813,807)</u>	<u>(742,661)</u>	<u>1,486,196</u>	<u>—</u>	<u>1,486,196</u>

Deferred income taxes have been recorded in the accompanying statements of assets, liabilities, and stockholders' equity – income tax basis for the tax effects of temporary differences that impact the financial statements and income tax returns in different periods, offset partially by carryforwards for

**BILOXI MARSH LANDS CORPORATION**

Notes to Financial Statements – Income Tax Basis

December 31, 2011 and 2010

federal and state income tax purposes of unused net operating losses and tax credits. The primary components of deferred tax (assets) liabilities are as follows:

	<u>2011</u>	<u>2010</u>
Deferred tax assets:		
Net operating loss and tax credit carryforwards	\$ (813,807)	—

Net operating loss (NOL) and tax credit carryforwards outstanding of \$1,520,271 federal and \$2,193,149 state as of December 31, 2011 expire in 2031 and 2026, respectively.

Nontaxable revenues and nondeductible expenses may result in reporting net income for tax basis financial statements that differs from taxable income reported on the tax return. The reconciliation of U.S. federal statutory and effective income tax rates is shown below:

	<u>2011</u>		<u>2010</u>	
Statutory rate	(503,516)	35.0%	1,897,160	35.0%
Percentage depletion	—	—	(456,608)	(8.4)
State taxes provided	(171,702)	11.9	103,064	1.9
Effect of graduated rates	(38,339)	2.7	(39,048)	(0.7)
Other (net)	(29,104)	2.0	(18,372)	(0.4)
Effective tax rate	<u>(742,661)</u>	<u>51.6%</u>	<u>1,486,196</u>	<u>27.4%</u>

Management believes that it is more likely than not that the deferred tax assets will be realized through future operations and the reversal of other temporary differences.

Federal alternative minimum tax credits of \$71,146 have unlimited carryforward periods.

**(5) Stockholders' Equity**

**(a) Common Stock**

Holder of common stock are entitled to one vote per share, to receive dividends, and, upon liquidation or dissolution, are entitled to receive all assets available for distribution to stockholders.

**(b) Rights Plan**

On November 6, 2003, the board of directors of the Company adopted a shareholder rights plan. Pursuant to the rights plan by and between the Company and the Company (as Rights Agent), authorized and declared a dividend of one preferred share purchase right for each outstanding share of common shares of the Company on November 20, 2003, payable November 21, 2003. Each right entitles the holder to purchase from the Company one one-hundredth of a share of Series A Junior.

## BILOXI MARSH LANDS CORPORATION

### Notes to Financial Statements – Income Tax Basis

December 31, 2011 and 2010

Participating Preferred Stock, with a par value of \$0.001, at a price of \$90.00 per one one-hundredth of a share. The rights, however, will not become exercisable unless and until, among other things, any person acquires 15% or more of the outstanding common shares of the Company. If a person acquires 15% or more of the outstanding common shares (subject to certain conditions and exceptions more fully described in the Rights Agreement), each right will entitle the holder (other than the person who acquired 15% or more of the outstanding common shares) to purchase preferred stock of the Company at a favorable price. The rights have no voting power, and unless the rights are redeemed, exchanged, or terminated earlier, they will expire on October 31, 2013.

**(c) Repurchase Plan**

On September 26, 2008, the board of directors authorized the purchase of up to 27,500 shares of its outstanding common stock. The purchases will be made from time to time on the open market at the sole discretion of the Company. All shares purchased will be held as treasury stock. For the period ended December 31, 2011 and 2010, the Company acquired shares of 6,100 and 0, respectively, to arrive at total cumulative shares as of December 31, 2011 and 2010 of 19,100 and 13,000, respectively, under this plan. The authorization to purchase shares expires upon completion of targeted goal. On September 13, 2011, the board of directors authorized the additional purchase of 13,000 shares of its outstanding common stock, thus bringing the total authorized amount to 40,500.

**(d) Dividends**

The Company paid cash dividends on common stock of \$1,505,420 and \$3,426,785 in 2011 and 2010, respectively.

**(6) Commitments and Contingencies**

On September 27, 2010, the Company entered into a settlement agreement of all cases involving disputed water bottoms between the Company and the State of Louisiana. The settlement involved proportionately sharing the funds with the State of Louisiana that were previously deposited in various concursus accounts. On October 13, 2010, the Mineral and Energy Board approved the settlement agreements and the funds were disbursed to the Company in December 2010 and January 2011. The Company's share of the settlement was \$5,205,463, which was recognized in 2010 as revenues and income in the accompanying statements of revenues and expenses – income tax basis. As of December 31, 2011, all amounts due under the settlement were collected.

**(7) Subsequent Events**

The Company has evaluated subsequent events from the statements of assets, liabilities, and stockholders' equity – income tax basis date through March 5, 2012, the date at which the financial statements – income tax basis were available to be issued, and determined there are no other items to disclose.

## BILOXI MARSH LANDS CORPORATION

Schedule of Marketable Securities  
December 31, 2011 and 2010

Company description	2011				2010			
	Shares/ face value	Cost	Fair value	Unrealized gains (losses)	Shares/ face value	Cost	Fair value	Unrealized gains
Common stock:								
3 D Systems Corp.	37,100	\$ 280,817	534,240	253,423	25,000	\$ 330,202	787,250	457,048
Abbott Labs	—	—	—	—	7,800	372,602	373,698	1,096
Bank of America Corporation	—	—	—	—	22,000	277,102	293,480	16,378
BE Aerospace, Inc.	15,400	558,742	596,134	37,392	—	—	—	—
Carter's Inc.	—	—	—	—	13,000	301,483	383,630	82,147
Cleco Corporation	—	—	—	—	7,800	168,372	239,928	71,556
Constant Contact, Inc.	29,600	676,829	687,016	10,187	—	—	—	—
Cullen Frost Bankers Inc.	9,600	484,384	507,936	23,552	6,700	336,906	409,504	72,598
EPIQ Systems Inc.	39,800	512,848	478,396	(34,452)	27,400	338,272	376,202	37,930
Euronet Worldwide, Inc.	31,000	579,415	572,880	(6,535)	—	—	—	—
FedEx Corp.	7,000	565,629	584,570	18,941	4,200	327,410	390,642	63,232
Flowers Foods, Inc.	28,000	556,763	531,440	(25,323)	—	—	—	—
Iberia Bank Corp.	—	—	—	—	7,100	356,819	419,823	63,004
Ion Geophysical Corp.	77,300	606,408	473,849	(132,559)	12,000	95,661	101,760	6,099
Jos A Bank Clothiers, Inc.	11,100	578,536	541,236	(37,300)	—	—	—	—
Luminex Corp.	30,000	401,570	636,900	235,330	23,000	282,882	420,440	137,558
McDonald's	—	—	—	—	5,000	334,047	383,800	49,753
McMoran Exploration Co.	15,000	213,093	218,250	5,157	—	—	—	—
Northern Oil and Gas, Inc.	26,400	539,530	633,072	93,542	—	—	—	—
O'Reilly Automotive Inc.	—	—	—	—	8,800	183,905	533,632	349,727
Pool Corporation	23,000	523,692	692,300	168,608	18,000	393,356	405,720	12,364
Smucker, JM Co.	—	—	—	—	6,300	298,774	413,595	114,821
Sandridge Energy, Inc.	70,000	538,941	571,200	32,259	6,000	196,763	415,680	218,917
Varian Medical System Inc.	10,000	433,129	671,300	238,171	11,200	318,679	400,736	82,057
Verizon Communications	—	—	—	—	—	—	—	—
Visa, Inc.	7,300	515,708	741,169	225,461	—	—	—	—
Total common stock		\$ 8,566,034	\$ 9,671,888	\$ 1,105,854		\$ 4,913,235	\$ 6,749,520	\$ 1,836,285
Corporate bonds:								
Abbott Laboratories	—	—	—	—	300,000	300,025	302,135	2,110
Wells Fargo & Co.	300,000	301,525	310,489	8,964	300,000	301,525	321,729	20,204
General Electric Capital Corp.	—	—	—	—	300,000	291,448	320,971	29,523
JPMorgan Chase & Co.	300,000	295,525	313,626	18,101	300,000	295,525	320,949	25,424
Caterpillar Fin Serv Corp	—	—	—	—	300,000	300,330	326,457	26,127
DuPont El Nemour	—	—	—	—	300,000	297,775	327,323	29,548
Wal-Mart Stores Inc.	300,000	300,262	317,337	17,075	300,000	300,262	313,600	13,338
Merkel & Co Inc.	300,000	300,775	334,691	33,916	300,000	300,775	329,969	29,194
General Electric Capital Corp.	300,000	300,025	337,450	37,425	300,000	300,025	328,197	28,172
Whitney National Bank Sub NO	300,000	265,515	304,530	39,015	500,000	442,525	480,500	37,975
Total corporate bonds		\$ 1,763,627	\$ 1,918,123	\$ 154,496		\$ 3,130,215	\$ 3,371,830	\$ 241,615
Total marketable securities		\$ 10,329,661	\$ 11,590,011	\$ 1,260,350		\$ 8,043,450	\$ 10,121,350	\$ 2,077,900

See accompanying independent auditors' report.