

Biloxi Marsh Lands Corporation

One Galleria Blvd., Suite #902

Metairie, Louisiana 70001

Phone: (504) 837-4337

Fax: (504) 837-1889

March 19, 2013

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, 2012. The annual revenue breakdown is as follows: 2012 revenue from oil and gas activity for the Company's fee lands was \$572,559 compared to revenue of \$1,503,056 in 2011.

During 2012, total revenues included a \$714,604 loss emanating from the Company's investment in B&L Exploration, LLC (B&L). This compares to a loss of \$3,423,042 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 \$800,488 and \$1,801,797 for 2012 and 2011, respectively.

Meanwhile, dividend and interest income for 2012 was \$199,024 compared to \$254,128 for 2011. In 2012, we realized a cumulative gain from the sale of investment securities of \$23,630 compared to a cumulative gain in the amount of \$1,600,569 in 2011. Expenses for the year totaled \$983,083 compared to \$1,439,114 for the prior year. For the year, the Company incurred a net loss of \$460,635 or \$0.17 per share compared to a net loss of \$695,955 or \$.25 per share in 2011.

As of December 31, 2012 the combined gross daily production rate from 4 wells operated by the Company's mineral lessees was approximately 3.8 million cubic feet (mmcf) of natural gas with net daily production accruing to the Company of approximately .492 mmcf. The Company has been advised by Alta Mesa, one of the Company's mineral lessees, that the Ducros/SL 17958 well is going to be plugged and abandoned after several unsuccessful attempts to rework the well.

As of December 31, 2012, B&L's net production breakdown was approximately 1.0 mmcf and 40 barrels of oil per day from 5 wells. This compares to B&L's net production of 2.4mmcf and 100 barrels of oil per day as of December 31, 2011 from 6 wells. As previously reported, Hurricane Isaac impacted production when the storm came through the region in late August. All wells were shut-in prior to the storm. The Goodrich Land and Energy No. 1 well, CL&F No. 1 well, and Harry Bourg No.1 well were placed back on production shortly after the storm and sustained minimal damage. The SL 19061 #1 well and Delacroix #41 ST well sustained damage during the storm, and after repairs, these wells were returned to production during the third quarter. As of December 31, 2012, B&L has working interests in 7 wells capable of production and to which proved reserves are assigned. It should be noted that 2 of the 7 wells in which B&L has a working interest were temporarily shut-in, thus not producing on December 31, 2012.

The SL 19706 No. 1 well located in Coquille Bay in Plaquemines Parish, Louisiana, and operated by Clayton Williams Energy, Inc. ("CWE") was returned to production on January 22, 2013 and is currently flowing from the 19 sand interval on a 10/64th choke at an approximate rate of 2.0 mmcf per day and 43 barrels of oil per day.

McMoRan Exploration Co. (NYSE:MMR) reported on January 18, 2013 its Fourth-Quarter/ Twelve-Month 2012 Results which included an update of MMR's "*Ultra-Deep Exploration and Development Activities*" including "*The Lomond North ultra-deep prospect, which is located in the Highlander area, primarily in St. Martin Parish, Louisiana, is currently drilling below 13,500 feet. This exploratory well has a proposed total depth of 30,000 feet and is targeting Eocene, Paleocene and Cretaceous objectives below*

the salt weld. McMoRan controls rights to approximately 80,000 gross acres in Iberia, St. Martin, Assumption and Iberville Parishes, Louisiana. McMoRan is operator and currently holds a 72.0 percent working interest. McMoRan's investment in Lomond North totaled \$40.1 million at December 31, 2012." The first string of 16" production casing was set in late January of 2013 at 13,697 feet. As of the beginning of March 2013, McMoRan continues the drilling of the Lomond North Well and has reached a depth of approximately 16,704 feet measured depth. As previously reported, B&L is contractually entitled to a 1.5% of 8/8ths overriding royalty interest in the Lomond North prospect exploratory well and in all mineral leases obtained by MMR in this approximately 80,000 gross acre Highlander area located in Iberia, St. Martin, Assumption and Iberville Parishes, Louisiana.

As previously reported, during the June 20, 2012 Central Gulf of Mexico Lease Sale, B&L was the high bidder and successfully obtained the mineral rights to Eugene Island Block 74. Based on B&L's recently commissioned independent reservoir engineer's study, this lease block is projected to contain significant natural gas and oil Proved Undeveloped (PUD) reserves with significant additional upside potential in undrilled fault blocks. B&L holds a 60% working interest in Eugene Island Block 74, and it will be necessary to drill wells to access the PUD reserves and additional upside potential. B&L is seeking partners to develop this highly prospective offshore lease block.

Additionally, B&L and its partners have obtained mineral rights to a 1,320 acre lease position in Allen Parish, Louisiana. The objective is to test the Middle and Lower Wilcox sands. B&L is actively seeking industry participants to develop this lease position.

Meanwhile, 2D seismic acquisition operations were completed during the fourth quarter of 2012 on B&L's Phoenix Prospect in Union Parish, Louisiana. B&L and its operating partner, Greystone Oil & Gas, LLP, are interpreting and mapping the seismic in hopes of developing potential drilling prospects. B&L and Greystone control approximately 7,000 gross acres in Union Parish. The objective in this prospect is the upper Smackover intervals as well as Lower Smackover Brown Dense formation.

As previously reported, in addition to the foregoing projects/prospects, B&L is actively assembling additional prospective acreage on which to explore, exploit and develop the acreage's mineral interest. The goal is to place a portion of the working interests with industry partners in an effort to mitigate risk. Due to this strategic shift, B&L only participated in drilling 2 wells during 2012 compared to 4 wells drilled during 2011.

A reflection of the success of B&L's strategy is its recent acquisition of approximately 50 square miles or 30,000 acres of mineral and surface rights in Calhoun and Victoria County, Texas. This project is identified as B&L's Lago Verde 3D Seismic Project. On September 18, 2012, field operations for the collection of proprietary 3D seismic data over this 50 square mile area commenced. This focus area is situated in the prolific oil rich leg of the Frio trend with adjacent fields having produced in excess of 200 million barrels of oil (MMBO) and 1.8 trillion cubic feet (TCF) of natural gas. The potential targets are Miocene and Oligocene which are relatively shallow ranging from 3,000 feet to 11,000 feet and are drilled with land rigs.

B&L successfully placed a significant working interest in its Lago Verde project with the Bass Group with main offices in Fort Worth, Texas. B&L is operating the 3D seismic survey and BOPCO, the operating company for the Bass Group, will operate any wells that may be drilled within this Lago Verde project area. B&L hopes to have completed seismic data collection operations by the end of March 2013, and 3D data processing is anticipated to take five to six weeks from completion of the 3D data collection operations. B&L maintains a 33.5% working interest in the Lago Verde project.

The final end of the year proved reserve study commissioned by the Company and completed by T. J. Smith & Company, Inc., an independent reservoir engineer, estimates that as of December 31, 2012 BLMC's "Developed Producing" (PDP) reserves were .297 billion cubic feet (BCF) of natural gas and estimates that the "Developed Non-Producing" (PDNP) reserves were .521 BCF, totaling .818 BCF of estimated proved natural gas reserves. Additionally, this reserve study estimates that approximately 14% of the proved reserves will deplete by the end of 2013.

Please find the following table showing the Company's proved reserves as of December 31, 2012:

Proved Reserves as of December 31, 2012 (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):	.297	.521	.818
Estimated Future Net Revenues (before income taxes) (2):.....		\$	2,128 (4)
Estimated Discounted Future Net Revenues (before income taxes) (2):.....		\$	1,561 (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, 2012. The oil price of \$94.71 per barrel is based on the West Texas Intermediate (WTI), Cushing, Oklahoma spot prices. The natural gas price of \$2.76 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 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 in which the final report estimates that B&L's proved reserves were approximately 8.5 billion cubic feet of natural gas (BCF) and approximately 194 thousand barrels of oil (MBBL) as of December 31, 2012 which compares to 2.4 billion cubic feet (BCF) of natural gas and 81 thousand barrels of oil (MBBL) at the end of 2011. It should be noted that a significant component of B&L's proved reserves as of December 31, 2012 are Proved Undeveloped (PUD). As is necessary with all PUD reserves, a well or wells must be drilled and completed to fully develop these PUD reserves.

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, 2012 we have been successful in purchasing a total of 38,400 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.

In 2012 the Company filed a claim with the BP Deepwater Horizon Economic and Property Damages Settlement Facility administered by Patrick Juneau for damages to and loss of its wetlands. We have been advised by our legal counsel that a limited recovery under the settlement is expected, but as of this time it is difficult to determine the timing and amount of the settlement, if any.

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. In December 2012, the members approved the consolidation of all the membership classes into a single class of membership, consistent with the Class A membership. All appropriate actions were taken according to the terms of the operating agreement with respect to the consolidation. Effective January 1, 2013, BLMC and LKEU will have membership percentages of 75% and 25%, respectively.

During its meeting held on December 11, 2012, the Board of Directors declared a dividend of \$.25 per outstanding share of common stock payable on Thursday, December 27, 2012 to shareholders of record at the close of business on Friday, December 21, 2012. This represents a total cash dividend payment of \$679,007 or \$.25 per share in 2012. Since 2002, the Company has paid approximately \$52,400,000 in total dividends. With the Company's fee land based production depleting and no new wells being drilled on its fee lands, it will be difficult to maintain the level of dividends paid since 2002. With this said, using 3D seismic data in its possession, the Company is constantly working on developing the minerals located below its fee lands. Meanwhile, the Company is focusing on developing reserves outside of its fee acreage and diversifying into oil production through its investment in B&L. In its current stage of growth and continued reinvestment in its successful drilling program and development of prospects, B&L should not be viewed as a dividend producing entity.

Please remember to visit our website, 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.

Meanwhile, we are pleased with the results of B&L's partial strategic shift from participating in the drilling of prospects generated by third parties to acquiring mineral acreage positions and focusing on placing a portion of those interests with industry partners to assist in drilling and development. While this partial shift in strategy has temporarily slowed B&L's drilling program, thus a reason for the short term decline in daily production, overtime this strategy should prove to mitigate B&L's drilling risk, improve its economics and lead to an accelerated drilling program during the second half of 2013 and into 2014. Evidence of the success of this shift in strategy is the placement of a significant interest in our Lago Verde 3D Seismic acquisition program with the Bass Group. B&L's proved reserves have increased significantly year over year from 2.4 billion cubic feet (BCF) of natural gas and 81 thousand barrels of oil (MBBL) at the end of 2011 to approximately 8.5 billion cubic feet of natural gas (BCFG) and approximately 194 thousand barrels of oil (MBBL) as of December 31, 2012. As of December 31, 2012, B&L had working interests in seven producing wells. At the end of the 2012, B&L's Developed Producing (PDP) and Developed Non-Producing (PDNP) proved reserves had a gross value net of development and operating expenses of approximately \$5.8mm, while its Proved Undeveloped (PUD) reserves had a gross value net of development and operating expenses of approximately \$17.5mm, totaling

approximately \$23.3mm in proved reserves. This compares to a gross value of approximately \$18mm net of development and operating expenses as of December 31, 2011. It should be noted in addition to the foregoing, B&L has 1.5% overriding royalty interest in McMoRan Exploration's 80,000 acre Highlander Project area in which McMoRan is currently drilling its Lomond North exploratory well. This overriding royalty interest could represent substantial value to B&L, and thus to the Company.

2013 will be another 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@gmail.comⁱ

ⁱ 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, 2012 and 2011

(With Independent Auditors' Report Thereon)

BILOXI MARSH LANDS CORPORATION

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

Independent Auditors' Report

The Board of Directors
Biloxi Marsh Lands Corporation:

Report on the Financial Statements

We have audited the accompanying financial statements – income tax basis of Biloxi Marsh Lands Corporation (the Company), which comprise the statements of assets, liabilities, and stockholders' equity – income tax basis as of December 31, 2012 and 2011, 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, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements – income tax basis in accordance with the basis of accounting the Company uses for income tax purposes; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements – income tax basis that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements – income tax basis. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements – income tax basis, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements – income tax basis in order to design 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. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements – income tax basis.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements – income tax basis referred to above present fairly, in all material respects, the assets, liabilities, and stockholders' equity – income tax basis of Biloxi Marsh Lands



Corporation as of December 31, 2012 and 2011, and its 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 in accordance with the basis of accounting the Company uses for income tax purposes described in note 1 (b).

Basis of Accounting

We draw attention to note 1 (b) of the financial statements, which describes the basis of accounting. The financial statements are prepared on the basis of accounting the Company uses for income tax purposes, which is a basis of accounting other than U.S. generally accepted accounting principles. Our opinion is not modified with respect to this matter.

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.

Other Matter

Our audit was 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 audit 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, 2013

BILOXI MARSH LANDS CORPORATION

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

December 31, 2012 and 2011

Assets	<u>2012</u>	<u>2011</u>
Current assets:		
Cash and cash equivalents	\$ 1,802,767	3,220,432
Accounts receivable	112,763	146,516
Accrued interest receivable	19,275	22,250
Prepaid expenses	36,113	39,987
Deferred tax asset	426,345	813,807
Federal income taxes receivable	—	16,136
State income taxes receivable	177,850	14,160
Marketable debt securities – at cost	295,525	301,525
Other assets	3,830	3,830
Total current assets	<u>2,874,468</u>	<u>4,578,643</u>
Investment in partnership	2,571,253	1,335,857
Marketable debt and equity securities – at cost	9,173,122	10,028,136
Land	234,939	234,939
Levees and office furniture and equipment	307,323	298,429
Accumulated depreciation	<u>(303,454)</u>	<u>(298,429)</u>
Total assets	<u>\$ 14,857,651</u>	<u>16,177,575</u>
Liabilities and Stockholders' Equity		
Current liabilities:		
Income taxes payable	\$ 14,386	—
Accrued expenses	20,526	19,345
Other current liabilities	4,608	4,410
Total current liabilities	<u>39,520</u>	<u>23,755</u>
Stockholders' equity:		
Common stock, \$0.001 par value. Authorized, 20,000,000 shares; issued, 2,851,196 shares; outstanding, 2,716,028 and 2,735,328 shares in 2012 and 2011, respectively	47,520	47,520
Retained earnings	15,212,071	16,351,713
Treasury stock, 135,168 and 115,868 shares in 2012 and 2011, respectively, at cost	<u>(441,460)</u>	<u>(245,413)</u>
Total stockholders' equity	<u>14,818,131</u>	<u>16,153,820</u>
Total liabilities and stockholders' equity	<u>\$ 14,857,651</u>	<u>16,177,575</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, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Revenues:		
Oil and gas royalties	\$ 553,326	1,519,192
Severance taxes	(30,767)	(66,136)
Oil and gas royalties, net	522,559	1,453,056
Surface rentals	50,000	50,000
Total oil and gas revenues	<u>572,559</u>	<u>1,503,056</u>
Other (loss) income:		
Loss from investment in partnership	(714,604)	(3,423,042)
Dividends and interest income	199,024	254,128
Gain on sale of securities	23,630	1,600,569
Surface rentals	31,772	22,145
Other	85,916	43,642
Total other loss	<u>(374,262)</u>	<u>(1,502,558)</u>
Total revenues and income	<u>198,297</u>	<u>498</u>
Expenses:		
Salaries	164,000	204,000
Bonuses	70,000	240,000
Payroll taxes	12,556	16,866
Employee benefits	24,047	33,187
Association dues	850	850
Accounting and auditing	90,333	121,076
Gas marketing fees	3,233	8,512
Consultants	53,070	91,872
Depreciation	5,025	20,750
Directors' fees	80,000	157,750
Franchise taxes	89,392	119,004
Insurance	107,629	102,744
Land management fees	46,531	26,804
Legal fees	16,937	59,588
Other	100,448	115,469
Portfolio services	70,925	68,709
Property taxes	18,382	17,341
Rent	29,725	33,092
Charitable contributions	—	1,500
Total expenses	<u>983,083</u>	<u>1,439,114</u>
Net loss before income taxes	(784,786)	(1,438,616)
Income tax benefit	<u>(324,151)</u>	<u>(742,661)</u>
Net loss	<u>\$ (460,635)</u>	<u>(695,955)</u>
Net loss per share	\$ (0.17)	(0.25)

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, 2012 and 2011

	Common stock		Treasury stock		Retained earnings	Total
	Shares	Amount	Shares	Amount		
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
Net loss	—	—	—	—	(460,635)	(460,635)
Purchase of treasury shares	—	—	(19,300)	(196,047)	—	(196,047)
Dividends	—	—	—	—	(679,007)	(679,007)
Balance, December 31, 2012	<u>2,851,196</u>	<u>\$ 47,520</u>	<u>(135,168)</u>	<u>\$ (441,460)</u>	<u>15,212,071</u>	<u>14,818,131</u>

See accompanying notes to financial statements – income tax basis.

BILOXI MARSH LANDS CORPORATION

Statements of Cash Flows – Income Tax Basis

Years ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash flows provided by operating activities:		
Net loss	\$ (460,635)	(695,955)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation	5,025	20,750
Gain on sale of securities	(23,630)	(1,600,569)
Loss from investment in partnership	714,604	3,423,042
Deferred income taxes	387,462	(813,807)
Change in operating assets and liabilities:		
Accounts and interest receivable	36,728	1,807,802
Due from related party	—	27,647
Prepaid expenses	3,874	(843)
Income taxes receivable and payable	(133,168)	(1,119,050)
Accrued expenses	1,181	(25,511)
Other current liabilities	198	450
Net cash provided by operating activities	<u>531,639</u>	<u>1,023,956</u>
Cash flows from investing activities:		
Proceeds from the sale of securities	3,782,661	6,669,810
Purchase of securities	(2,898,017)	(7,355,452)
Purchase of office furniture and equipment	(8,894)	(20,750)
Investment in partnership	<u>(1,950,000)</u>	<u>—</u>
Net cash used in investing activities	<u>(1,074,250)</u>	<u>(706,392)</u>
Cash flows from financing activities:		
Treasury stock purchased	(196,047)	(62,348)
Dividends paid	<u>(679,007)</u>	<u>(1,505,420)</u>
Net cash used in financing activities	<u>(875,054)</u>	<u>(1,567,768)</u>
Net decrease in cash and cash equivalents	(1,417,665)	(1,250,204)
Cash and cash equivalents, beginning of year	<u>3,220,432</u>	<u>4,470,636</u>
Cash and cash equivalents, end of year	\$ <u><u>1,802,767</u></u>	\$ <u><u>3,220,432</u></u>
Supplemental cash flow information:		
Cash received (paid) for income taxes	\$ 570,434	(1,190,196)

See accompanying notes to financial statements – income tax basis.

BILOXI MARSH LANDS CORPORATION

Notes to Financial Statements – Income Tax Basis

December 31, 2012 and 2011

(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 Louisiana and Texas.

(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 \$1,749,643 and \$2,435,913 of money market funds with an initial term of less than three months at December 31, 2012 and 2011, 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 exhausted and the potential for recovery is remote. The Company does not have any off-balance-sheet exposure related to its customers.

BILOXI MARSH LANDS CORPORATION

Notes to Financial Statements – Income Tax Basis

December 31, 2012 and 2011

(f) Investment Securities

Investment securities at December 31, 2012 and 2011 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 \$5,025 and \$20,750 in 2012 and 2011, 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 \$8,894 and \$20,750 in 2012 and 2011, respectively, were depreciated 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 liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

BILOXI MARSH LANDS CORPORATION

Notes to Financial Statements – Income Tax Basis

December 31, 2012 and 2011

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.

(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, 2012 and 2011 were as follows:

	<u>Cost basis</u>	<u>Gross unrealized gains</u>	<u>Gross unrealized losses</u>	<u>Fair value</u>
At December 31, 2012:				
Corporate bonds	\$ 1,462,102	137,986	—	1,600,088
Equity securities	<u>8,006,545</u>	<u>3,285,878</u>	<u>(159,306)</u>	<u>11,133,117</u>
	<u>\$ 9,468,647</u>	<u>3,423,864</u>	<u>(159,306)</u>	<u>12,733,205</u>
At December 31, 2011:				
Corporate bonds	\$ 1,763,627	154,496	—	1,918,123
Equity securities	<u>8,566,034</u>	<u>1,342,024</u>	<u>(236,170)</u>	<u>9,671,888</u>
	<u>\$ 10,329,661</u>	<u>1,496,520</u>	<u>(236,170)</u>	<u>11,590,011</u>

Maturities of corporate bonds were as follows at December 31, 2012:

	<u>Cost basis</u>	<u>Fair value</u>
Due within one year	\$ 295,525	303,984
Due after one through five years	<u>1,166,577</u>	<u>1,296,104</u>
	<u>\$ 1,462,102</u>	<u>1,600,088</u>

Cash proceeds from the sale of investment securities were \$3,782,661 and \$6,669,810 in 2012 and 2011, respectively. Realized cash gains from the sale of investment securities were \$23,630 and \$1,600,569 in 2012 and 2011, respectively. The Company had no investment securities with other-than-temporary declines in fair value at December 31, 2012.

BILOXI MARSH LANDS CORPORATION

Notes to Financial Statements – Income Tax Basis

December 31, 2012 and 2011

(3) Investment in Partnership

The Company owns an interest in B&L, an oil and gas exploration business. 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. Additionally, B&L has ownership interests in oil and gas properties on which seismic data is being collected that are being drilled or are yet to be drilled that are not included within the reserve estimates. The proved reserve estimates are not included in the table below summarizing financial information— income tax basis of B&L. 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. The operating agreement was amended in 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 is owned by Lake Eugenie Land & Development, Inc. In December of 2012, the B&L members agreed, effective January 1, 2013, to consolidate the membership classes into a single class of membership, consistent with the Class A membership of B&L. Beginning in January 1, 2013, the Company will own a 75% interest in B&L. The remaining 25% interest in B&L will be owned by Lake Eugenie Land & Development, Inc. The members will participate in current and future projects based on their respective 75% and 25% ownership interests. The carrying amount of the investment in B&L was \$2,571,253 and \$1,335,857 at December 31, 2012 and 2011, respectively. Summary financial information – income tax basis of B&L as of and for the years ended December 31, 2012 and 2011 (on the income tax basis of accounting) is as follows:

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 \$714,604 and \$3,423,042 of losses in 2012 and 2011, respectively.

	<u>2012</u>	<u>2011</u>
Financial position – income tax basis:		
Current assets	\$ 2,535,542	2,729,077
Mineral properties and equipment, net	4,300,735	1,795,987
Total assets	<u>\$ 6,836,277</u>	<u>4,525,064</u>
Current liabilities	<u>\$ 1,874,274</u>	2,869,442
Total current liabilities	1,874,274	2,869,442
Members' equity	4,962,003	1,655,622
Total liabilities and members' equity	<u>\$ 6,836,277</u>	<u>4,525,064</u>
Results of operations – income tax basis:		
Revenues, net	\$ 3,875,100	5,081,717
Net loss	(893,619)	(3,749,412)

BILOXI MARSH LANDS CORPORATION

Notes to Financial Statements – Income Tax Basis

December 31, 2012 and 2011

The Company is a co-guarantor of a \$7,500,000 revolving line of credit with a bank to be utilized by B&L. From time to time, B&L utilizes the credit facility during the ordinary course of its oil and gas operations, mainly to fund projects which B&L operates. The co-guarantee is allocated to the members based upon their respective membership Class percentages. As of December 31, 2012, the Company's guarantee is 75% of \$7,500,000, or \$5,625,000, which is consistent with its membership percentage. The line of credit expires November 26, 2015. Outstanding borrowings by B&L under the revolving line of credit were \$0 as of December 31, 2012 and 2011, 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, 2012, 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:

	2012			2011		
	Current	Deferred	Total	Current	Deferred	Total
Federal	\$ (539,912)	307,698	(232,214)	71,146	(642,105)	(570,959)
State	(171,701)	79,764	(91,937)	—	(171,702)	(171,702)
Total income tax expense (benefit)	\$ (711,613)	387,462	(324,151)	71,146	(813,807)	(742,661)

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 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:

	2012	2011
Deferred tax assets:		
Net operating loss and tax credit carryforwards	\$ (426,345)	(813,807)

Net operating loss (NOL) and tax credit carryforwards outstanding of \$682,982 federal and \$1,149,213 state as of December 31, 2012 expire in 2032 and 2027, 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:

	2012		2011	
Statutory rate	(274,675)	35.0%	(503,516)	35.0%
State taxes provided	(91,937)	11.7	(171,702)	11.9
Effect of graduated rates	6,830	(0.9)	(38,339)	2.7
Other (net)	35,631	(4.5)	(29,104)	2.0
Effective tax rate	(324,151)	41.3%	(742,661)	51.6%

BILOXI MARSH LANDS CORPORATION

Notes to Financial Statements – Income Tax Basis

December 31, 2012 and 2011

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 \$101,668 have unlimited carryforward periods.

(5) Stockholders' Equity

(a) *Common Stock*

Holders 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 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. 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 of shares under the plan to 40,500. The purchases have been and 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. The authorization to purchase shares expires upon completion of the targeted goal. For the periods ended December 31, 2012 and 2011, the Company acquired shares of 19,300 and 6,100, respectively, to arrive at total cumulative shares repurchased under this plan of 38,400 and 19,100, respectively, as of December 31, 2012 and 2011.

(d) *Dividends*

The Company paid cash dividends on common stock of \$679,007 and \$1,505,420 in 2012 and 2011, respectively.

BILOXI MARSH LANDS CORPORATION

Notes to Financial Statements – Income Tax Basis

December 31, 2012 and 2011

(6) Commitments and Contingencies

From time to time, the Company is involved in legal actions to defend title to its property. In the opinion of management, these matters are necessary to protect the Company's interests and the ultimate disposition of these matters will not have a material adverse effect on the Company's financial position, results of operations, or liquidity.

(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, 2013, 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, 2012 and 2011

Company description	2012				2011			
	Shares/ face value	Cost	Fair value	Unrealized gains (losses)	Shares/ face value	Cost	Fair value	Unrealized gains (losses)
Common stock:								
3 D Systems Corp	22,400	\$ 187,386	1,195,040	1,007,654	37,100	\$ 280,817	534,240	253,423
Apple Inc.	1,050	579,427	558,782	(20,645)	—	—	—	—
BE Aerospace, Inc.	15,400	558,742	760,760	202,018	15,400	558,742	596,134	37,392
Carnival Corp.	16,700	522,737	614,059	91,322	—	—	—	—
Constant Contact, Inc.	—	—	—	—	29,600	676,829	687,016	10,187
Cullen Frost Bankers Inc.	—	—	—	—	9,600	484,384	507,936	23,552
Endurance Specialty Holdings	13,200	520,489	523,908	3,419	—	—	—	—
EPIQ Systems Inc.	39,800	512,848	507,450	(5,398)	39,800	512,848	478,396	(34,452)
Euronet Worldwide, Inc.	31,000	579,415	731,600	152,185	31,000	579,415	572,880	(6,535)
FedEx Corp.	—	—	—	—	7,000	565,629	584,570	18,941
Flowers Foods, Inc.	28,000	556,763	651,560	94,797	28,000	556,763	531,440	(25,323)
Ion Geophysical Corp.	85,000	654,171	553,350	(100,821)	77,300	606,408	473,849	(132,559)
Jos A Bank Clothiers, Inc.	—	—	—	—	11,100	578,536	541,236	(37,300)
Luminex Corp.	30,000	401,570	503,955	102,385	30,000	401,570	636,900	235,330
McMora Exploration Co.	—	—	—	—	15,000	213,093	218,250	5,157
NIC Inc.	46,100	546,561	753,274	206,713	—	—	—	—
Northern Oil and Gas, Inc.	19,800	365,478	333,036	(32,442)	26,400	539,530	633,072	93,542
Pool Corporation	23,000	523,692	973,360	449,668	23,000	523,692	692,300	168,608
Sandridge Energy, Inc.	—	—	—	—	70,000	538,941	571,200	32,259
Smucker JM Co.	7,700	548,428	664,048	115,620	—	—	—	—
Varian Medical System Inc.	10,000	433,129	702,400	269,271	10,000	433,129	671,300	238,171
Visa, Inc.	7,300	515,709	1,106,535	590,826	7,300	515,708	741,169	225,461
Total common stock		8,006,545	11,133,117	3,126,572		8,566,034	9,671,888	1,105,854
Corporate bonds:								
Wells Fargo & Co.	—	—	—	—	300,000	301,525	310,489	8,964
JPMorgan Chase & Co.	300,000	295,525	303,984	8,459	300,000	295,525	313,626	18,101
Wal-Mart Stores Inc.	300,000	300,262	311,786	11,524	300,000	300,262	317,337	17,075
Merek & Co Inc.	300,000	300,775	327,371	26,596	300,000	300,775	334,691	33,916
General Electric Capital Corp.	300,000	300,025	330,937	30,912	300,000	300,025	337,450	37,425
Whitney National Bank Sub NO	300,000	265,515	326,010	60,495	300,000	265,515	304,530	39,015
Total corporate bonds		1,462,102	1,600,088	137,986		1,763,627	1,918,123	154,496
Total marketable securities		\$ 9,468,647	12,733,205	3,264,558		\$ 10,329,661	11,590,011	1,260,350

See accompanying independent auditors' report.