Pan Ocean Oil Corporation
Annual Report 1973

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Private Investor
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Thomas P. Sullivan, *Treasurer, Controller*
Isabel A. Dempsey, *Secretary*

Corporate Headquarters

Pan Ocean Building
645 Madison Avenue
New York, New York 10022

Transfer Agent and Registrar

Morgan Guaranty Trust Company of New York
New York, New York

The Canada Trust Company
Calgary, Alberta, Canada

Legal Counsel

Breed, Abbott & Morgan
New York, New York

Independent Accountants

Price Waterhouse & Co.
New York, New York

Arzanah No. 2 appraisal well drilling offshore Abu Dhabi in the Arabian Gulf.

Pan Ocean Oil Corporation

Pan Ocean Building, 645 Madison Avenue, New York, N.Y. 10022, Telephone: (212)832-1100, Cables: Panocoil NewYork, Telex: 12275

To Pan Ocean Oil Corporation Shareholders

We are pleased to advise you that on April 25, 1974 the American Stock Exchange approved Pan Ocean's application for the listing of its Common Stock. Trading is expected to commence in mid-May. The ticker symbol for Pan Ocean stock will be PNO.

Very truly yours,

Stanley R. Rawn, Jr.

Stanley R. Rawn, Jr.
Chairman of the Board,
President and Chief
Executive Officer

To our Shareholders

STANLEY R. RAWN, JR.

We are pleased to bring you our fifth Annual Report.

The past year was marked by two potentially significant discoveries—one onshore Nigeria, which tested over 8,000 barrels of oil per day, and the other offshore Abu Dhabi, which tested over 4,000 barrels of oil per day. Following the gas-condensate strike at Heimdal in the Norwegian North Sea late in 1972, this represents an unusual series of exploratory successes in three separate areas of the world within a relatively short period. The ultimate importance, however, of these recent two discoveries cannot be meaningfully assessed without further drilling and evaluation.

A significant gas discovery was made in the Pan Ocean-Gulf Canadian Exploration program during 1973 with the Robb well, which tested 18.5 million cubic feet of gas per day. Step-out drilling to evaluate the find will begin in 1974.

Considerable progress was made during 1973 in evaluation and development programs involving the Company's coal reserves in the Flathead Valley of British Columbia, its North Sea gas reserves at Heimdal, the uranium deposit at Rabbit Lake in Saskatchewan, and the fluorspar-zinc deposit in Kentucky.

Financial results for 1973 showed a slight improvement over comparable figures in 1972. Net income before an extraordinary item was $1,089,044, or $.10 per share, compared to $1,025,494, or $.10 per share in 1972. Net income after the extraordinary item was $2,031,951, or $.18 per share in 1973 compared to $1,305,424 or $.12 per share in 1972.

Net income, including the extraordinary gain, adjusted for a non-cash charge of $1,714,497 for depletion, depreciation and amortization was $3,746,448 in 1973. Additional cash of $3,475,477 was generated from the sale of minor Canadian properties at the end of the year. However, because of our Canadian full cost accounting policy, no recognition was given to this transaction in the income statement.

The Company's long-term debt, net of its current portion, was only $3,736,779 at the end of 1973. Working capital was $5,793,631. The Company anticipates increasing its borrowings during 1974 to finance its ongoing programs.

During 1974 Pan Ocean has scheduled its most ambitious exploration programs to date, including a minimum of 2 wells in the North Sea, 2 wells in Indonesia and 3 wells in Peru. At the same time, important appraisal drilling programs are planned for Nigeria and Abu Dhabi. Pan Ocean's budget for total exploration and appraisal drilling exceeds $15 million for 1974.

Five years ago, Pan Ocean was a new company seeking exploration rights in high potential areas. Since then, it has grown into a full energy company with substantial reserves of oil, gas, coal and other minerals, and with large scale exploration and development programs in progress in diversified locations around the world. The Company has shown an ability to competitively acquire valuable areas in many of the world's most prospective basins. As Pan Ocean has grown, it has also shown an ability to generate successful exploratory results. Our most important future challenge will be to translate these results into earnings. And, while we hope not to underestimate the time, financing and effort required to effect this, we are looking forward to the opportunities of this next stage of corporate growth.

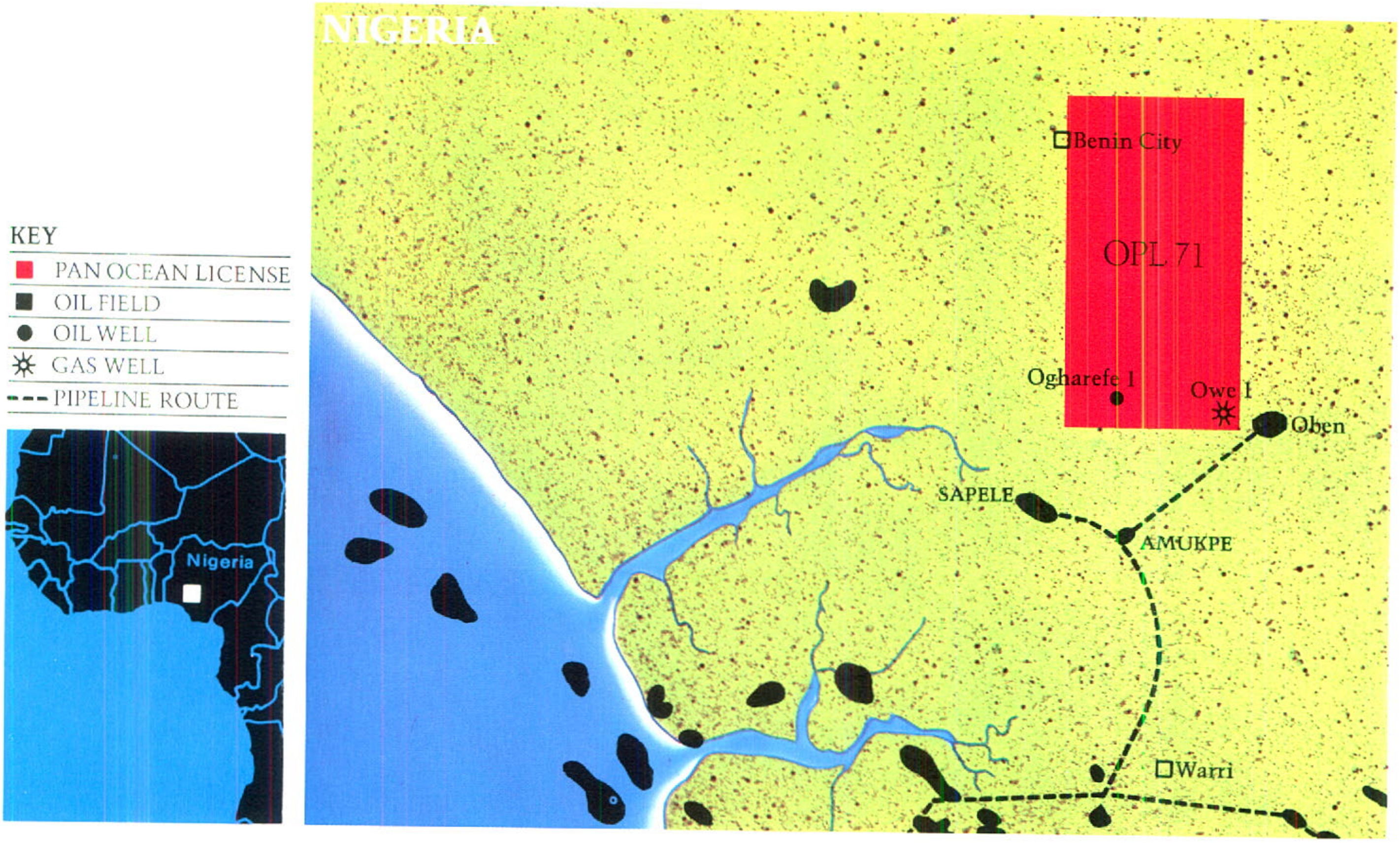
Our progress of the past year, as briefly described on the following pages of this Report, was the product of the group of people who comprise Pan Ocean. We take this opportunity to thank them and to thank our more than 20,000 shareholders for their support.

Respectfully submitted on behalf of the Board of Directors,

Stanley R. Rawn, Jr.

Chairman of the Board,
President and Chief Executive Officer

April 5, 1974



EXPLORATION

OIL AND GAS

On October 9, 1973, Pan Ocean announced that oil had been encountered in its Ogharefe No. 1 exploratory well located onshore **Nigeria.** The well tested at flow rates totaling in excess of 8,000 barrels per day through restrictive chokes from several zones. The gravity of the oil ranged from 42 to 46 degrees API with negligible sulphur content.

Pan Ocean first acquired exploration rights in Nigeria in February 1971. The Ogharefe No. 1 discovery well, the Company's fourth exploratory well in Nigeria, was drilled on a 248,320 acre license area known as OPL 71. After an extensive seismic program was carried out across the southern portion of OPL 71 during 1972, the Ogharefe No. 1 was spudded on March 19, 1973, and drilled to a total depth of 12,519 feet.

Pan Ocean holds 100% of the working interest in the discovery which lends particular importance to its potential for the Company. Pan Ocean operates in Nigeria in partnership with Delta Oil (Nigeria) Limited, a private Nigerian company which holds an overriding royalty interest in the license area.

Additional drilling and evaluation of the reservoir sands on the structure will be necessary before a reliable estimate can be made of reserves and of the potential value of the discovery.

Further detailed seismic work is now being conducted. A drilling unit has been contracted for a one-year period with an option to renew. The first appraisal well, which is scheduled to commence in April 1974, will be drilled one and a half miles southeast of the discovery well.

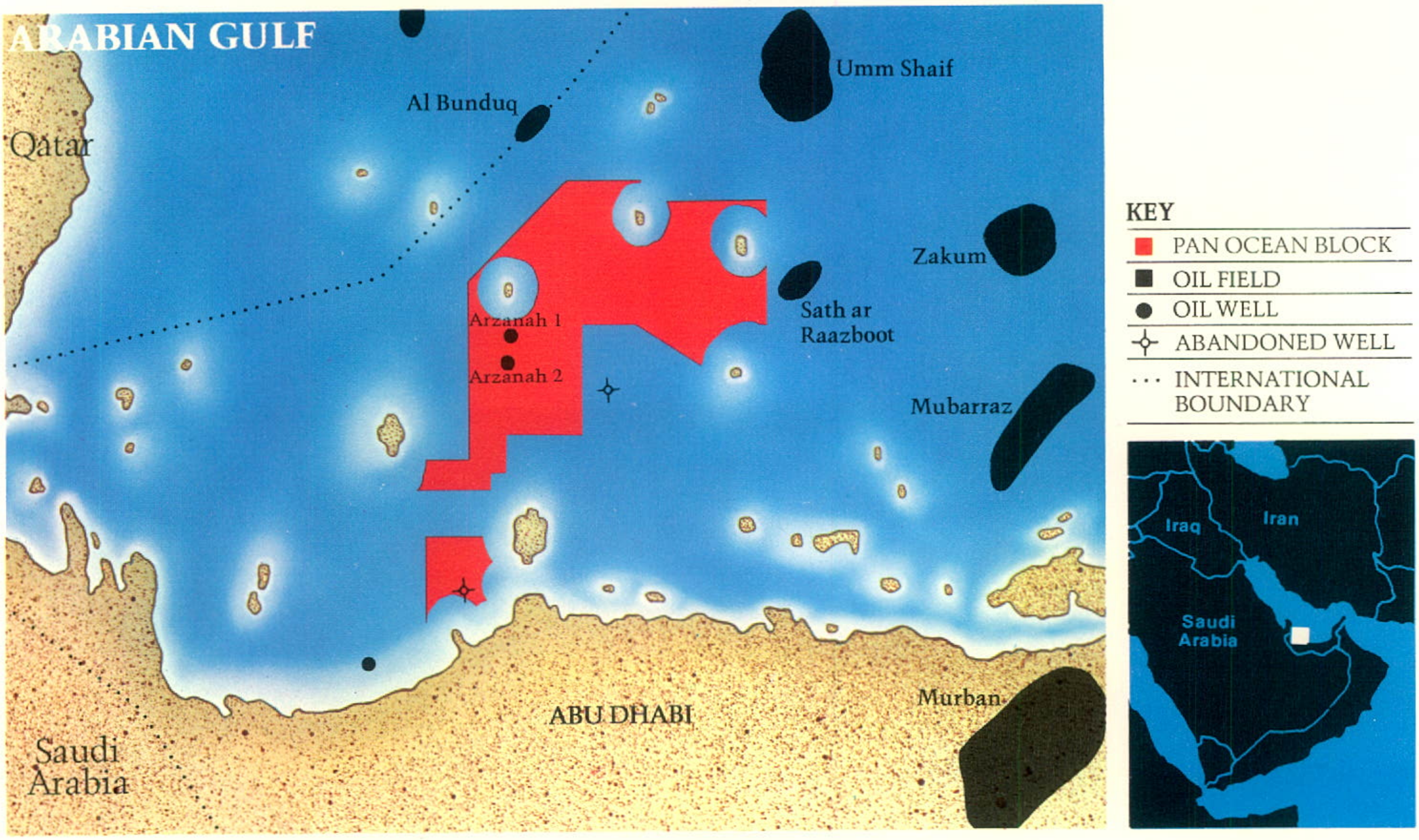
On December 14, 1973, it was announced that the Arzanah No. 1 well in the Arabian Gulf offshore **Abu Dhabi** had tested at aggregate flow rates in excess of 4,000 barrels per day of low-sulphur, high-gravity oil from several zones. Pan Ocean has a 31.5% interest in the discovery.

An appraisal well, the Arzanah No. 2, was commenced directly thereafter at a location three miles south of the discovery well. On April 3, 1974, it was announced that the Arzanah No. 2 had tested in excess of 5,000 barrels of oil per day. The drilling rig, which was committed under prior contract, has been released. Further drilling will be underway in the area as soon as a new drilling rig can be secured. Additional seismic work will begin shortly in the northern portion of the concession area.

The Abu Dhabi concession area encompasses 583,786 acres and was awarded to Pan Ocean by the Ruler of Abu Dhabi in June 1970. Following an initial seismic program, the first exploratory well was commenced in May

(Above) Oil and gas being flared during a flow test of Ogharefe No. 1 discovery well in Nigeria. (Left) Aerial view of Ogharefe No. 1 during a flow test, October 1973.

Testing the Arzanah No. 2 appraisal well offshore Abu Dhabi in the Arabian Gulf.



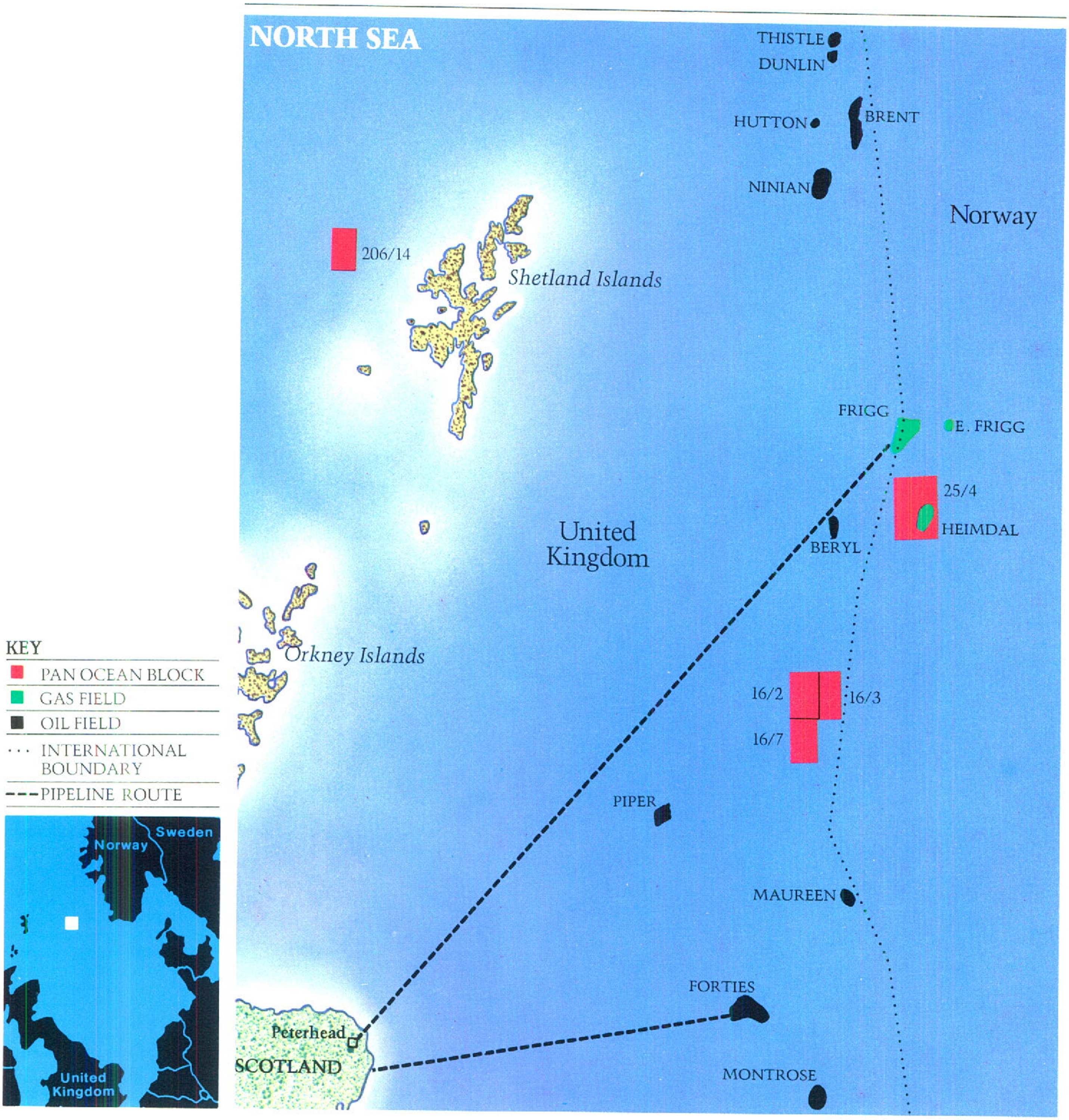
1971. At that time an agreement was entered into with Amerada Hess Corporation whereby Amerada Hess acquired one half of Pan Ocean's 63% interest in the concession. The first exploratory well was abandoned as a non-commercial gas well in October 1971. After an extensive seismic program during 1972, the Arzanah No. 1 discovery well was commenced on August 4, 1973. Additional drilling will be necessary to evaluate the significance of the find.

The Pan Ocean - Petronord Group announced a gas-condensate discovery in December 1972 on Block 25/4 in the **Norwegian North Sea.** The discovery, known as the Heimdal field, is located 22 miles south of Petronord's Frigg gas field, discovered in December 1970.

A second exploratory well was drilled during the fourth quarter of 1973 to the east of the main Heimdal feature, which resulted in an upward revision of the previous reserve estimates. Engineering studies related to platform design and development of the Heimdal field are underway. Seismic data is being processed to assist in selecting the location for a third exploratory well to be drilled on Block 25/4. The Norwegian Government-owned oil company, Statoil, has an option to acquire a 40% working interest and, assuming exercise of this option, Pan Ocean's interest would be reduced to 19.375%.

In the **U. K. North Sea** Pan Ocean has a 40% working interest in three adjacent Blocks, 16/2, 16/3 and 16/7. Blocks 16/3 and 16/7 were awarded by the Government in July 1970 and Block 16/2 was acquired in the last round of awards in March 1972. Extensive seismic programs have been carried out on these three blocks and two consecutive exploratory wells are scheduled to begin drilling in mid-1974. The newly commissioned semi-submersible drilling rig, the Odin Drill, has been contracted for these two wells. Pan Ocean is the operator.

Pan Ocean holds an 8.3% interest in Block 103/22 in the Celtic Sea and Block 206/14 west of the Shetland Islands, which were also part of the 1972 U. K. awards. Seismic programs were carried out during 1973 over these



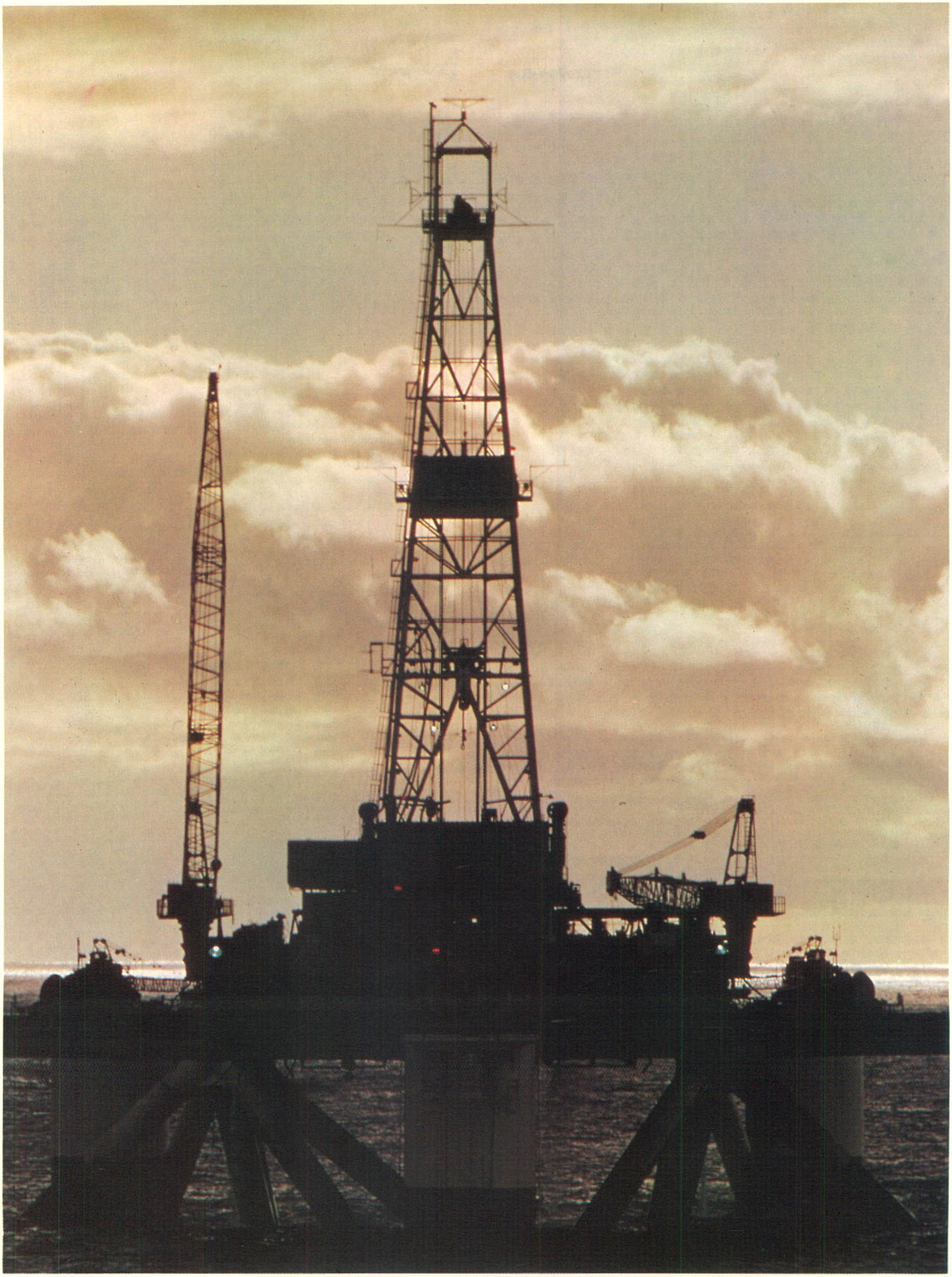
two Blocks and Elf/ERAP, the operator, has proposed an exploratory well on the Celtic Sea block in late 1974.

In the **Dutch North Sea** an initial seismic program was conducted during 1973 on Block P-4. Further seismic work is planned on Block Q-11 for 1974.

Pan Ocean's holdings in the North Sea now total 486,000 gross acres or 137,000 net acres.

The Company participated in the drilling of three exploratory wells in **Indonesia** last year. Two of the wells had no hydrocarbon showings and the third tested non-commercial amounts of 38 degree API gravity oil. Pan Ocean has a 35.1% interest in a standard Indonesian production sharing contract with Pertamina, the Indonesian national oil company. The contract presently covers an area of about 8 million acres located in the Malacca Straits offshore eastern Sumatra. Additional seismic work is in progress and two

— The Neptune 7 semi-submersible rig drilling Pan Ocean-Petronord exploratory well 25/4-2X, Norwegian North Sea, November 1973. —

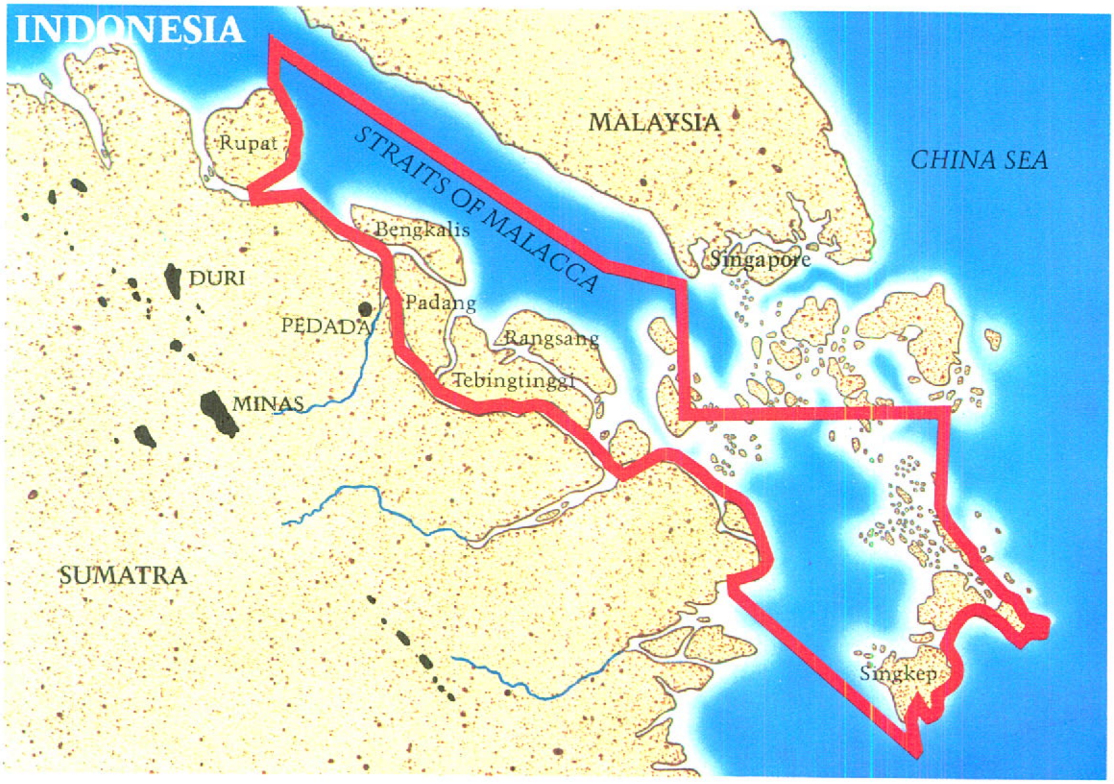


KEY

PAN OCEAN INTERESTS

■ OIL FIELD

● OIL WELL



Indonesian exploratory well MS J-1 drilling during June 1973 in the Malacca Straits between the islands of Padang and Tebingtinggi.

more exploratory wells are planned for 1974. Atlantic Richfield, operator for the contract area, expects drilling to begin during the summer.

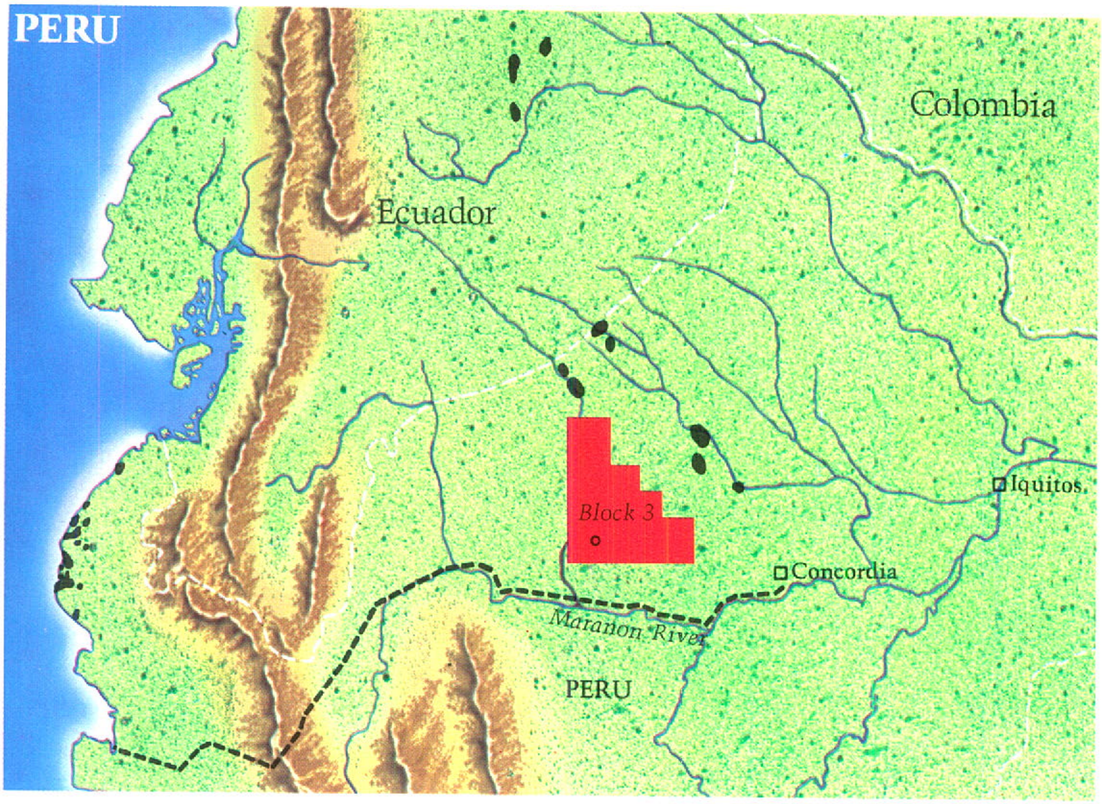
Pan Ocean was one of the first two companies in early 1970 to initiate negotiations in **Peru** for exploration rights in the Amazon Basin. The area originally requested is largely encompassed in Block 3, the 2.5 million acre block which was eventually awarded to Pan Ocean and partners under a production sharing contract with the national oil company, Petroleos del Peru (Petroperu). There are now a total of 12 groups of companies exploring in this part of the Amazon Basin, many with initial drilling scheduled to begin during 1974.

The Pan Ocean group has shot over 1,600 miles of seismic lines in the

(Above) Clearing operations on Block 3 in the Amazon Basin, Peru. (Left) Cargo vessel being loaded in Texas with drilling equipment bound for Block 3 in the Amazon Basin, Peru.

KEY

- PAN OCEAN BLOCK
- OIL FIELD
- WELL LOCATION
- PIPELINE ROUTE



difficult jungle terrain since April 1972 and detailed seismic work is still in progress. Seismic results have been encouraging and indicate a number of large drillable features. A drilling rig designed for jungle operations was constructed last year in Texas and arrived in Iquitos, Peru on February 27. Components of the rig are now being moved by barge and helicopter to the location for the first test well. The first test, which will be drilled to a depth of approximately 16,000 feet, is scheduled to begin in April. A minimum of four exploratory wells will be drilled on the Block. Pan Ocean has a 25% interest in the production sharing contract. Petroperu has a 54% carried interest. Getty Oil Company is the operator.

On a 15 million acre concession granted by the **Republic of the Maldives** in the Indian Ocean, 1,214 miles of additional seismic shooting was performed last year and Elf/ERAP, as operator, has proposed a further 1,242 miles of seismic shooting during 1974. Seismic results have been encouraging and exploratory drilling may begin in 1975. Pan Ocean holds a 7.875% interest in the concession.

On April 2, 1974, Panarctic Oils Ltd. announced that the Hecla N-52 exploratory well offshore Melville Island in the Canadian **Arctic** confirmed an eight-mile extension of the Hecla gas field. The well, drilled from a floating ice platform, is the first offshore well to be drilled in the Arctic Islands, and tested 7.1 million cubic feet of gas per day through a restricted choke. Under the terms of a 1972 agreement, Panarctic earned a 50% interest in two blocks held by Pan Ocean and others offshore Melville Island, thereby reducing Pan Ocean's interest to 12.5%. The Hecla N-52 was drilled approximately 1.5 miles west of one of these blocks, A-2473. Panarctic drilled the Hecla F-62 discovery well, located approximately 1.5 miles east of block A-2473, in December 1972 and a southern step-out well, Hecla I-69, in April 1973. Both of these wells were located onshore, although the southern step-out was directionally drilled offshore. Seismic results indicate a structure extending between the onshore discovery well and the new offshore discovery well across Pan Ocean's block A-2473. While the potential gas reserves could prove to be substantial, the timing of any market realization of Arctic gas is as yet unknown.

In 1972 Pan Ocean entered into a four-year $21.5 million joint exploration program in **Canada** with Gulf Oil Canada Limited. Pan Ocean acquired 25% of Gulf's interest in 2.4 million gross acres of Gulf's prospective untested lands in Alberta and British Columbia in return for committing $17 million of exploration funds. Pan Ocean formed a limited partnership, Pan Ocean Exploration Partnership, in which the limited partners supply the exploration funds and Pan Ocean supplies the funds to develop discoveries made in the program. Such development costs are shared 25% by Pan Ocean and 75% by Gulf. After Pan Ocean has first recovered 110% of its development costs and the limited partners have then recovered their exploration costs, Partnership revenue is shared equally. At the end of the four-year period, Pan Ocean retains the full 25% interest in any untested acreage.

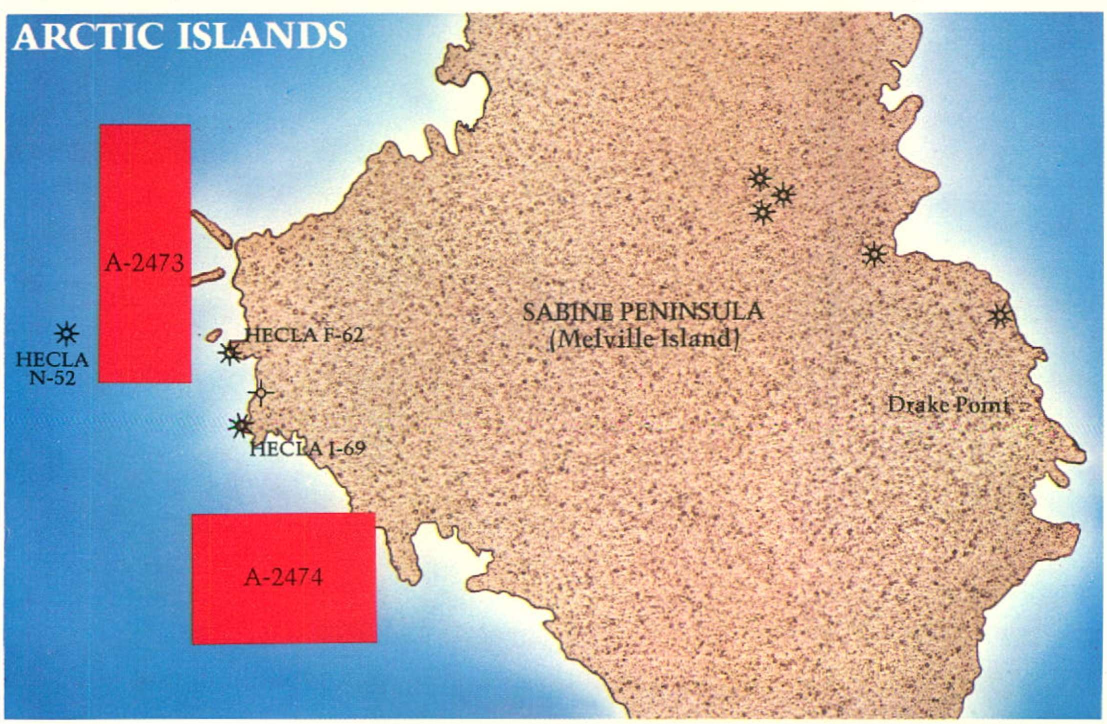
The drilling program is currently near the end of its second year. To date, 42 wells have been drilled in the program, of which 13 have been completed as potential gas wells. In addition, nine wells have been drilled outside the program through farmout arrangements with third parties on joint venture lands, resulting in two oil discoveries and two gas discoveries. Of principal significance in the program was a gas discovery announced last June in the Robb area of the Alberta foothills. The 14,000 foot Robb well tested 18.5 million cubic feet of gas per day from two zones. Further drilling on the Robb structure is planned during 1974. A deep foothills exploratory well in the second year's program is currently drilling below 7,000 feet toward a 12,500 foot objective.

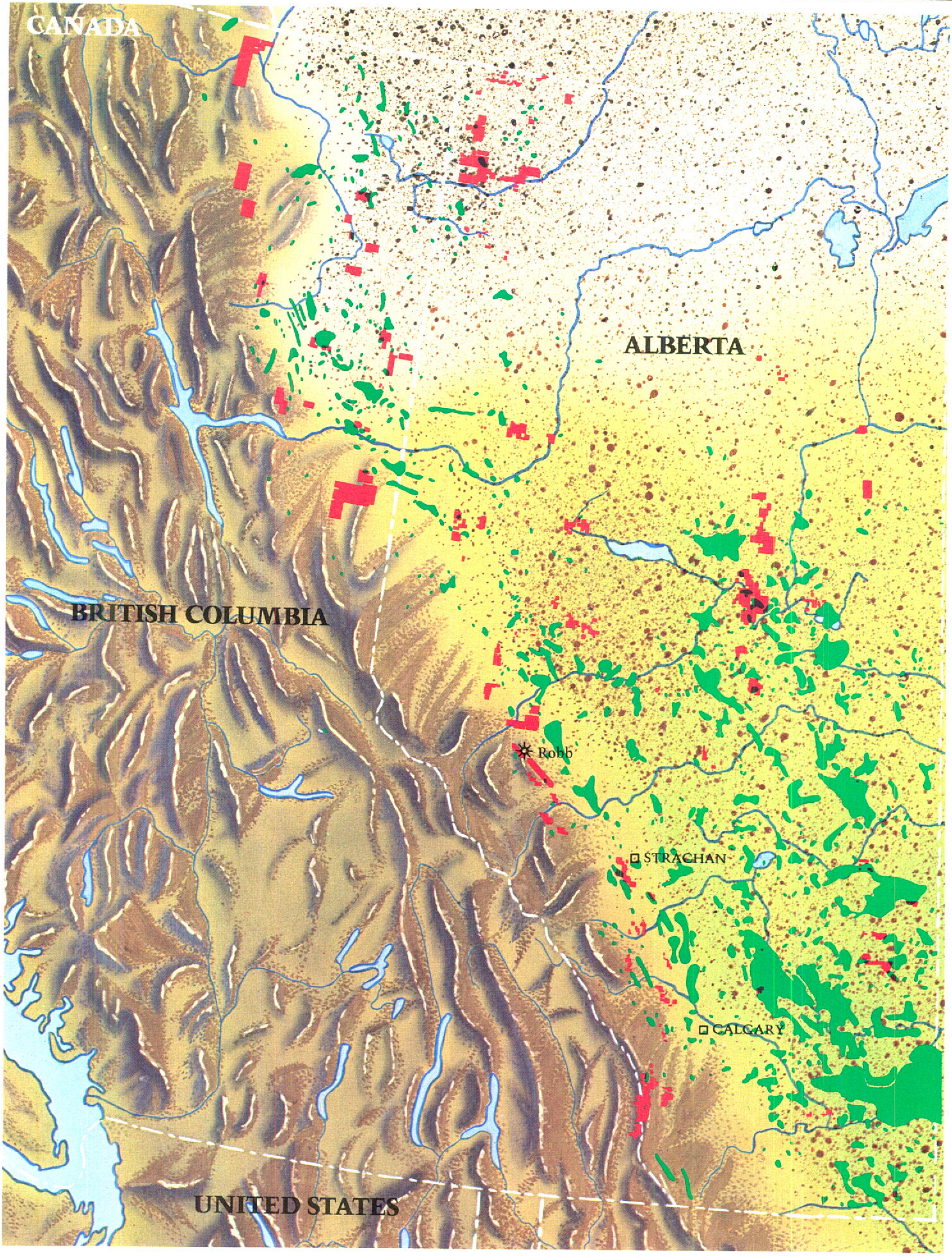
In the **United States** Pan Ocean and its 83%-owned subsidiary, Frontier Resources, Inc., are undertaking a joint oil exploration program in Wyoming which is expected to involve approximately $4 million in total expenditures over the next two and a half years.

MINERALS

URANIUM

After a number of years of static demand and depressed uranium prices, the sharp upswing in projected nuclear plant construction throughout the





PAN OCEAN INTERESTS GAS FIELD GAS WELL

world has resulted in a similar upswing in future contracted prices for uranium. In anticipation of an accelerating demand for uranium, Pan Ocean during the past two years has been aggressively accumulating a land position and is in varying stages of preliminary exploration in several different areas of the world.

In the **United States** the Company's mineral activities are carried out through its subsidiary Frontier Resources, headquartered in Denver. Based on extensive research, Frontier Resources has acquired about 70,000 acres of prospective uranium lands in New Mexico, Montana and Utah. An exploratory drilling program on Frontier Resources' acreage is expected to commence during 1974.

In the Baker Lake area of the Northwest Territories in **Canada,** an additional 518 mineral claims were staked last year, which brings the total mineral claims of Pan Ocean and its partners in this area to 1,202. Early in 1974 this group was granted an additional 1.5 million acres of Permits in this area.

Gulf Minerals Canada Limited carried out an active exploratory drilling program during 1973 on lands adjoining the Rabbit Lake ore body presently under development in northern Saskatchewan. The level of exploratory drilling is expected to increase from $1 million in 1973 to approximately $4 million in 1974, and to further increase in 1975. Pan Ocean's net profits interest will attach to any discoveries made on these lands.

Legislation is expected in Canada this year which will probably establish certain limitations on foreign ownership of uranium reserves in Canada. Pan Ocean will be examining its present interests and on-going exploratory programs with a view toward integrating these with Canadian policy.

Pan Ocean Oil Ltd. in conjunction with two partners has acquired Prospecting Permits from the Government of **Niger** in northwest Africa covering approximately 160 million acres. Most of this acreage will be released by 1975 as a result of geological studies and airborne surveys planned for the fall of 1974. A Pan Ocean office has been opened in the capital city of Niamey.

Pan Ocean conducted both airborne and field programs last year over permit areas totaling approximately one million acres in Southern and Western **Australia** and exploration work will continue in 1974.

OTHER MINERALS

Exploratory drilling near **Salem, Kentucky** has indicated one new fluorspar deposit and one new fluorspar-lead-

Support helicopter for Pan Ocean's uranium exploration operations at Baker Lake, Northwest Territories.

zinc deposit, both within ten miles of the Eagle Babb Barnes deposit now being mined. Frontier Resources holds an 18% interest in all of these deposits. The latter discovery is undergoing further drilling to establish parameters for a detailed feasibility study to be undertaken. Through another joint venture, Frontier Resources is undertaking a gold exploration program in Alaska, Nevada and Utah.

Only a modest level of exploration activity took place last year on Company holdings in **Canada** which are prospective for zinc, copper and coal. Pine Pass Development Ltd. carried out limited drilling on a portion of Pan Ocean's 62,365 acres of coal leases in Northeastern British Columbia last year and will conduct further drilling in 1974 toward earning a 60% interest in the property. In 1973 the Company negotiated a farmout to Imperial Oil Limited on 15,460 acres of Pan Ocean mineral claims in an area of recent lead-zinc discoveries in Nova Scotia. Further test drilling will continue on this property in 1974.

PRODUCTION AND DEVELOPMENT

In 1973, 46% of our operating revenue was derived from the **Strachan** gas field and processing plant in Alberta. In July of last year construction of LPG recovery facilities at the Strachan plant was completed and plant capacity increased from 250 to 275 million cubic feet per day. However, during 1973 TransCanada PipeLines Limited elected to purchase gas volumes only slightly higher than their minimum daily contract requirements, resulting in a 20% reduction in gas sales from 1972 levels. Major renegotiation of existing gas sale contracts did not progress beyond the discussion stage last year. Minor upward revisions were obtained late in the year which were substantially offset by subsequent increases in Alberta royalties. Price renegotiation discussions are continuing.

Cores being examined from test holes drilled to evaluate fluorspar-lead-zinc discovery near Salem, Kentucky.

Construction of a proposed rail line within four miles of the Strachan plant now makes marketing of our sulphur production a possibility within the coming 12 months. Posted sulphur prices have risen sharply in the past year and plant prices exceeding $15 per ton should be realized when handling and delivery facilities permit. We are presently producing sulphur at Strachan at an annual rate of 62,000 tons to our interest and have currently stockpiled in excess of 160,000 tons.

Construction of the uranium mine-mill complex at **Rabbit Lake** by Gulf Minerals Canada Limited continued on schedule and production start-up is expected in the first half of 1975. Pan Ocean has an 8.75% net profits interest in sales from the Rabbit Lake ore body and from any new discoveries found on 227,000 acres of adjoining lands. After payout of development costs, Pan Ocean's net profits interest increases to 17.5%. Under the terms of the agreement Gulf first recovers its total exploration costs before making any payments on Pan Ocean's net profits interest. Earlier projections had indicated Pan Ocean's income to commence during 1975. However, as a result of substantial upward revisions in Gulf's exploratory budget for 1974 and 1975, new projections indicate income to Pan Ocean may be deferred until 1977. The new projections, however, also indicate that new increased prices for uranium will increase the total return to Pan Ocean very substantially through 1985 as compared to the earlier projections. Additional reserves that might result from this greater level of exploration activity would further enhance these income projections.

An intensified evaluation program was carried out by Rio Tinto Canadian Exploration Limited last year on the Company's coal lands in the **Flathead Valley** of British Columbia. Additional drilling and adits have outlined in excess of 100 million tons of high quality metallurgical coal. Bulk samples of the coal have been shipped to potential markets in Europe and Japan. A preliminary feasibility study is expected to be completed in April

1974. Rio Tinto has an option to acquire 60% of our interest in these lands.

Construction of the mine and mill for production of acid-grade fluorspar at **Salem, Kentucky** fell several months behind schedule because of last Spring's heavy rains. However, the mill has undergone start-up tests and is now in production. Cerro Corporation is operator of the project. Frontier Resources increased its interest in the fluorspar properties last year from 11.25% to 18%.

MANAGEMENT

During 1973 the Company announced the election of two new directors to the Board: George P. Giard, Jr., Vice President of Pan Ocean in New York, and Alaster G. Swanson, Vice President—Mining, located in Calgary and responsible for the Company's mineral activities worldwide. James F. Cowie was recently made Vice President of Pan Ocean Oil Ltd.

FINANCIAL

Gross operating revenue in 1973 was \$7,112,459 compared to \$7,059,141 in 1972, despite a 20% reduction in gas sales in 1973 from the Strachan plant.

Net income before an extraordinary item was \$1,089,044, or \$.10 per share in 1973, compared to \$1,025,494, or \$.10 per share in 1972. Net income, after an extraordinary gain from the sale of the Ozona gas properties in Texas, was \$2,031,951, or \$.18 per share, compared to net income of \$1,305,424, or \$.12 per share in 1972.

Net income, including the extraordinary gain, adjusted for a non-cash charge of \$1,714,497 for depletion, depreciation and amortization was \$3,746,448. The sale of several Canadian minor-income producing properties generated an additional \$3,475,477 in cash in 1973. However, because of the Company's full cost policy in Canada, these sales are not reflected in the income statement.

On November 30, 1973, the Company's \$10 million 8% Convertible Subordinated Note was converted into 800,000 shares of common stock. The Note, issued in 1970 and due in 1985, was held by Neil A. McConnell, a director of the Company. Its conversion eliminates an \$800,000 annual interest obligation and substantially reduces long-term debt. At the end of 1973 Pan Ocean's long-term debt was only \$3,736,779, net of its current portion, compared with a total shareholders' equity of \$54,647,158.

At the end of 1973, the Company had current assets of \$10,353,187 against current liabilities of \$4,559,556. Expenditures budgeted for 1974 in excess of working capital and cash generated by operations are expected to be met by long-term borrowing.

In April 1973, Pan Ocean transferred all of its producing oil and gas properties in the United States to Frontier Resources in exchange for 682,300 shares of Frontier Resources stock. This resulted in an increase of Pan Ocean's ownership of Frontier Resources from 73% to 83%.

The Company has over 20,000 shareholders of record located in all 50 States and every Province of Canada. Canadians represent 57% of our shareholders and hold 45% of the Company's outstanding shares.

Uranium mine-mill complex under construction at Rabbit Lake, Saskatchewan.

OIL AND GAS EXPLORATORY INTERESTS

LOCATION	PAN OCEAN INTEREST	ACREAGE GROSS	ACREAGE NET
1 ABU DHABI	31.5%	583,786	183,893
2 CANADA			
(a) Alberta, Saskatchewan, British Columbia and Yukon	Various 10%-100%	779,145	223,714
(b) Arctic Islands	Various .6%-25%	8,402,109	779,448
(c) East Coast Offshore	Various 10.2%-50%	2,357,271	477,631
(d) Hudson's Bay	Various 16.67%-45%	2,285,110	494,527
3 EAST CHINA SEA†	70%	10,000,000	7,000,000
4 GHANA	Various 0.4%-2.1%	1,256,960	14,770
5 INDONESIA	35.1%	7,861,734	2,759,460
6 ITALY			
Adriatic Sea	37.5%	110,073	41,278

LOCATION	PAN
7 MALDIVE ISLANDS (Indian Ocean)	
8 NIGERIA	
9 NORTH SEA	
Dutch Sector	
Block Q-11	
Block Q-14	
Block P-4	
Norwegian Sector	
Block 25/4	
United Kingdom Sector	
Blocks 16/2, 16/3 & 16/7	
Blocks 103/22 & 206/14	
10 PERU	

TOTAL OIL AND GAS ACREAGE:* Gross—56,715,129; Net—18,443,615

OCEAN INTEREST	ACREAGE GROSS	ACREAGE NET
7.875%	15,100,586	1,189,125
100%	248,320	248,320
24.7%	40,021	9,901
28.8%	5,931	1,708
9.89%	40,021	3,958
36.9%	129,480	47,778
40%	162,820	65,128
8.3%	108,000	8,997
25%	2,510,536	627,634

LOCATION	PAN OCEAN INTEREST	ACREAGE GROSS	ACREAGE NET
11 THAILAND	100%	3,952,544	3,952,544
12 TUNISIA	33.3%	185,819	61,939
13 UNITED STATES			
(a) Alaska	Various 37.5%-75%	107,461	79,658
(b) Colorado, Montana, North Dakota and Wyoming	Various 12.5%-100%	487,402	172,204

†Lease application—priority filing.

*Does not include:
(1) Acreage held in the Pan Ocean—Gulf Oil Canada joint exploration venture.
(2) Acreage held by Magnorth Petroleum Ltd. in the Arctic.
(3) Acreage in which Pan Ocean holds royalty interests.
(4) Mineral acreage.

Consolidated Balance Sheets

	December 31, 1973	December 31, 1972
ASSETS		
Current assets:		
Cash	$ 1,237,159	$ 1,397,842
Time deposits	2,843,232	13,518,959
Marketable securities, at cost (approximate market value—1973—$303,019; 1972—$274,900)	312,623	271,794
Receivable from sale of oil and gas properties (Note 4)	4,156,510	—
Accounts receivable	1,563,457	1,423,372
Prepaid expenses and other assets	124,989	190,812
Income tax refund	115,217	83,574
Total current assets	10,353,187	16,886,353
Properties and equipment, at cost (Notes 2, 3, 4 and 9):		
Developed oil and gas properties	17,614,464	19,687,414
Undeveloped leaseholds, mineral rights and mining claims	42,390,297	29,441,914
	60,004,761	49,129,328
Less—Accumulated depletion, depreciation and amortization	8,494,940	6,669,500
	51,509,821	42,459,828
Other assets:		
Furniture and fixtures, net of accumulated depreciation 1973—$285,955; 1972—$216,916	381,146	389,090
Investments, at cost	710,000	399,037
Loan to officer	—	53,333
Other	548,045	592,140
	1,639,191	1,433,600
Total assets	$63,502,199	$60,779,781
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 1,805,089	$ 1,731,212
Accrued liabilities	294,467	57,108
Long-term debt due within one year (Note 7)	2,460,000	1,582,600
Total current liabilities	4,559,556	3,370,920
Long-term debt (Note 7)	3,736,779	15,837,867
Deferred income (Note 5)	100,000	—
Deferred income taxes (Note 6)	140,000	140,000
Minority interest in consolidated subsidiaries (Note 1)	318,706	295,328
Shareholders' equity (Notes 1 and 8):		
Common stock $.01 par value—authorized 30,000,000 shares; issued and outstanding 12,190,257 shares in 1973 and 11,247,524 shares in 1972	121,903	112,475
Preferred stock $1.00 par value—authorized 5,000,000 shares; issued—none	—	—
Capital in excess of par value	70,901,820	59,431,707
Deficit	(16,376,565)	(18,408,516)
Total shareholders' equity	54,647,158	41,135,666
Commitments and contingencies (Note 11)	—	—
Total liabilities and shareholders' equity	$63,502,199	$60,779,781

The accompanying notes are an integral part of these statements.

Consolidated Statements of Income and Deficit

	For the year ended December 31, 1973	1972
Revenues:		
Sales and other operating revenue	$ 7,112,459	$ 7,059,141
Interest and dividend income	757,516	493,936
Gain on sales of interest in oil and gas properties	4,381	506,253
Other income (Note 5)	250,000	6,262
	8,124,356	8,065,592
Costs and expenses:		
Production and lease operating expenses	1,301,973	1,318,454
Depletion, depreciation and amortization	1,714,497	1,561,743
Interest expense	1,308,917	1,330,204
General and administrative expenses	2,872,471	2,689,697
	7,197,858	6,900,098
Income before income taxes and minority interest	926,498	1,165,494
Provision for deferred income taxes (Note 6)	—	140,000
Income tax credit (Note 6)	(183,546)	—
	1,110,044	1,025,494
Minority interest in consolidated subsidiaries	21,000	—
Income before extraordinary items	1,089,044	1,025,494
Extraordinary items:		
Gain on sale of developed properties (Note 9)	942,907	—
Gain on sale of securities	—	279,930
	942,907	279,930
Net income	2,031,951	1,305,424
Deficit, beginning of year	(18,408,516)	(19,713,940)
Deficit, end of year	($16,376,565)	($18,408,516)
Per average share of common stock and common stock equivalents (Note 10):		
Income before extraordinary items	$.10	$.10
Extraordinary items	.08	.02
Net income	$.18	$.12

The accompanying notes are an integral part of these statements.

Consolidated Statements of Changes in Financial Position

	For the year ended December 31, 1973	1972
Financial resources were provided by:		
Income before extraordinary items	$ 1,089,044	$ 1,025,494
Add—Charges (income) not requiring the outlay of funds:		
Depletion, depreciation and amortization	1,714,497	1,561,743
Provision for deferred income taxes	—	140,000
Minority interest	21,000	—
Other income	(250,000)	—
Working capital provided by operations	2,574,541	2,727,237
Working capital provided by extraordinary items:		
Gain on sale of securities	—	279,930
Proceeds on sales of developed properties	5,675,477	—
Proceeds on sales and dispositions of interests in undeveloped properties, net	453,083	—
Issuances of common stock:		
For developed and undeveloped properties	908,600	120,587
Acquisition of a subsidiary	—	55,000
Proceeds from sales of common stock	566,277	13,895,046
For conversion of subordinated note	10,000,000	—
Deferred income	350,000	—
Total source of funds	20,527,978	17,077,800
Financial resources were used for:		
Additions to properties and equipment:		
Developed oil and gas properties	1,743,882	949,907
Undeveloped oil, gas and mineral properties	14,145,895	9,591,062
Furniture and fixtures	61,095	2,619
	15,950,872	10,543,588
Increase in investments	310,963	306,788
Purchase of minority interest in The Dynamic Group of Companies	—	82,839
Reduction of long-term debt	12,101,088	87,843
Other items, net	(113,143)	(98,889)
Total application of funds	28,249,780	10,922,169
Increase (decrease) in working capital	(7,721,802)	6,155,631
Working capital at beginning of year	13,515,433	7,359,802
Working capital at end of year	$ 5,793,631	$13,515,433
Changes in components of working capital:		
Increase (decrease):		
Current assets—		
Cash	($ 160,683)	($ 2,809,487)
Time deposits	(10,675,727)	6,631,830
Marketable securities	40,829	(1,235,487)
Accounts receivable	140,085	(187,651)
Prepaid expenses and other assets	(65,823)	115,614
Income tax refund	31,643	(1,397,888)
Receivable from sale of oil and gas properties	4,156,510	—
	(6,533,166)	1,116,931
Current liabilities—		
Accounts payable	73,877	(41,330)
Accrued liabilities	237,359	(494,107)
Long-term debt due within one year	877,400	(4,503,263)
	1,188,636	(5,038,700)
Increase (decrease) in working capital	($ 7,721,802)	$ 6,155,631

The accompanying notes are an integral part of these statements.

Statements of Common Stock and Capital in Excess of Par Value

	Common stock	Capital in excess of par value
Balance at December 31, 1971	$ 98,311	$45,445,975
For the period January 1, 1972 to December 31, 1972:		
Proceeds from public offering of 990,000 shares of common stock, less $307,591 expense of issue	9,900	9,780,509
Proceeds from private placement of 400,000 shares of common stock for cash	4,000	4,076,000
Proceeds from sales of 2,658 shares of common stock relating to exercise of stock options	27	24,610
Issuance of additional 2,500 shares of common stock in connection with acquisition of Interocean Oil Company, Inc.	25	54,975
Issuance of 10,039 shares of common stock in connection with undeveloped leasehold interests	100	120,487
Issuance of 1,000 shares of common stock in connection with services rendered	10	11,990
Issuance of additional 10,191 shares of common stock in connection with the merger with The Dynamic Group of Companies	102	—
Purchase of additional common stock of The Dynamic Group of Companies, cancelled pursuant to merger agreement	—	(82,839)
Balance at December 31, 1972	112,475	59,431,707
For the period January 1, 1973 to December 31, 1973:		
Adjustment in the purchase of common stock of The Dynamic Group of Companies, cancelled pursuant to merger agreement	—	4,664
Proceeds from sales of 61,733 shares of common stock relating to exercise of stock options	618	565,659
Issuance of 81,000 shares of common stock in connection with the acquisition of properties	810	907,790
Issuance of 800,000 shares of common stock in connection with the conversion of subordinated note	8,000	9,992,000
Balance at December 31, 1973	$121,903	$70,901,820

The accompanying notes are an integral part of these statements.

Notes to Consolidated Financial Statements

Note 1—Organization:

Pan Ocean Oil Corporation was incorporated on September 4, 1968. On February 5, 1971 Pan Ocean and United Bata Resources Limited (N.P.L.) (Bata) effected a merger whereby a total of 3,080,487 shares of Pan Ocean common stock were issued for the common shares of Bata. On December 22, 1971 Pan Ocean effected a merger with eight Canadian companies known as The Dynamic Group of Companies. Pursuant to the combination terms Pan Ocean issued 1,977,343 shares of its common stock in exchange for more than 90% of the outstanding shares of The Dynamic Group of Companies. These mergers were treated as poolings of interest for accounting purposes and the accompanying consolidated financial statements have been adjusted retroactively to include the operations of Bata and Dynamic.

In a series of transactions over the past several years Pan Ocean also acquired certain developed natural gas properties and several companies having assets consisting primarily of proven or producing oil and gas properties, interest in undeveloped properties, marketable securities and minority holdings of common stock in certain oil and gas companies. These acquisitions were accounted for as purchases and recorded at the fair value of assets acquired. The statements of income and loss include the operations of such companies from their respective dates of acquisition.

These acquisitions are summarized as follows:

Acquisition date	Company/property acquired	Pan Ocean shares issued
1969/1970	Developed natural gas properties in Crockett County, Texas	454,366
February 9, 1970	Vaneil Properties, Inc.	326,531
June 30, 1970	Pocantico Oil & Gas Corp.	140,000
July 2, 1970	Ocean Platinum Company	13,412
February 26, 1971	Interocean Oil Company, Inc. (including 2,500 shares issued in 1972)	95,215
September 30, 1971	Tur-Kan Petrol Ltd.	5,792

In 1972 the company completed a public offering of 990,000 of its common shares resulting in net proceeds of $9,790,409. Simultaneously, the company had a private placement with a director and an officer of the company of 400,000 shares with net proceeds of $4,080,000.

During 1972, the company acquired a 72% interest in Frontier Resources, Inc. for $1,358,000. Frontier's assets consist principally of interest in undeveloped mineral properties in the United States. In 1973, Pan Ocean acquired an additional 5,000 shares for $8,350 cash and 682,300 shares in exchange for producing oil and gas properties valued at approximately $1,800,000, thereby increasing the company's interest in Frontier to 83%.

Pan Ocean, including the companies combined through poolings of interest, is engaged primarily in the acquisition and exploration of interests in undeveloped oil, gas and mineral acreage in Canada, the United States and various other countries throughout the world. Income results principally from the production of discovered reserves.

Note 2—Accounting Policies:

Oil and gas properties:

The company had followed the total cost method of accounting for the cost of its oil and gas properties. Under this method all acquisition, exploration and development costs were initially capitalized. Depletion, depreciation and amortization of the capitalized costs of producing properties were provided for generally on a unit-of-production basis as oil and gas reserves were produced. Costs associated with unsuccessful properties were written off at the time such properties were abandoned or surrendered.

In 1972 the company adopted retroactively the full-cost method of accounting for the costs of its oil and gas properties outside of the United States because management is of the opinion that all costs, whether for successful or unsuccessful properties, are a part of the overall cost of discovering reserves. Management believes capitalization of all oil and gas exploration costs, including costs associated with unsuccessful properties and amortization of such costs, on a pro rata basis as the discovered oil and gas reserves are produced, results in a more meaningful matching of costs and related revenues.

Under the company's full cost method, costs are accumulated separately in three cost centers, Canada, United States and Other Foreign Areas. All developed and undeveloped property costs accumulated for the Canadian cost center are being amortized using the unit-of-production method based upon estimated proven developed reserves. For the United States, costs of developed properties are being depleted on a unit-of-production basis. Exploration activities in the United States are relatively minor. Accordingly, undeveloped property costs are being deferred until such time as reserves are discovered or the property is sold or abandoned. Gains or losses on disposition of undeveloped properties in the United States are recognized and included in the results of operations. Costs incurred in Other Foreign Areas are being deferred pending the results of exploration programs. These costs will be amortized as discovered reserves for the Other Foreign Area cost center are developed and produced. Except for the United States, no gain or loss is ordinarily recognized on the disposal of any properties.

The company has developed reserves in Canada and the United States and undeveloped reserves in Other Foreign Areas. The net capitalized costs which include developed and undeveloped properties for Canada and Other Foreign Areas will be limited to the value of the recoverable oil and gas reserves applicable to each of the cost centers. For the United States, net capitalized costs for developed properties will be limited to the value of recoverable reserves in the United States.

Mineral properties:

In 1972 the company also adopted the full-cost method for all of its mineral properties exclusive of coal. The company's mineral properties are presently in the exploration or development stage and all costs and expenses related thereto, including costs associated with unsuccessful properties, have been capitalized. No depletion, depreciation or amortization will be provided on the properties until production commences. The net capitalized costs of mineral properties will be limited to the value of recoverable mineral reserves.

Consolidation:

The consolidated financial statements include the accounts of the company and its majority-owned subsidiaries. All intercompany accounts have been eliminated.

Foreign exchange:

Current assets and liabilities of foreign subsidiaries have been translated to U.S. dollars at rates of exchange in effect at the balance sheet dates, noncurrent assets and liabilities at the historical rates of exchange when the asset was acquired or liability incurred. Statements of income and deficit have been translated at exchange rates effective during the periods covered, except for depletion, depreciation and amortization which is based on the exchange rates at the time the applicable assets were acquired.

Note 3—Accounting Change:

As more fully explained in Note 2, the company adopted, in 1972, the full cost method of accounting for the costs of its oil, gas and mineral properties whereas in prior years the total cost method had been used. Accordingly, pursuant to Opinion No. 20 promulgated by the Accounting Principles Board of the American Institute of Certified Public Accountants, the financial statements of prior years have been restated to apply the new method retroactively. For income tax purposes, the company's previous policies have been continued. The effect of this change was to increase net income for 1972 by approximately $1,800,000 or $.17 per share. The 1972 accounting change adjustments to revenues and expenses relate principally to the elimination of gains and losses on the disposition or abandonment of undeveloped properties.

Note 4—Properties and Equipment:

Costs of properties for Canada, the United States and Other Foreign Areas are summarized as follows:

Developed oil and gas properties and related equipment:	December 31, 1973	1972
Canada:		
Producing lands and leases	$ 8,676,385	$ 9,484,631
Processing plant and related equipment	5,403,780	4719,168
Lease and well equipment	714,178	1,428,597
	14,794,343	15,632,396
United States:		
Producing lands and leases	1,894,280	2,154,701
Processing plant and related equipment	17,139	647,855
Lease and well equipment	908,702	1,252,462
	2,820,121	4,055,018
	$17,614,464	$19,687,414

During 1973 the company sold certain Canadian developed oil and gas properties for $3,475,477. For accounting purposes, the proceeds of the sale have been applied to and accordingly reduced the total capitalized costs of developed properties in Canada. In addition the company sold certain United States developed properties for $2,200,000. The gain recognized on this sale was $942,907 and was treated as an extraordinary item. Also during 1973, the company issued 71,000 shares valued at $816,500 for a Canadian-producing property.

Undeveloped properties:—	December 31, 1973	1972
Oil and gas:		
Canada	$10,112,383	$ 8,057,460
United States	312,975	774,288
Other Foreign Areas	26,664,756	16,907,176
	37,090,114	25,738,924
Mineral properties	5,300,183	3,702,990
	$42,390,297	$29,441,914

Based on engineering reports, the company estimates that the value of producing proven reserves in Canada exceeds the carrying value of the company's investment in developed and undeveloped oil and gas properties in Canada. In the United States the company estimates, based on engineering reports, that the value of producing proven reserves exceeds the carrying value of the company's investment in developed properties in the United States. Undeveloped reserves outside of Canada and the United States have an estimated value which exceeds the company's total investment in undeveloped oil and gas properties in Other Foreign Areas.

The value of the company's mineral reserves exceeds the investment in undeveloped mineral properties.

Note 5—Deferred and Other Income:

In June 1973, Pan Ocean entered into an agreement with Astrodata, Inc. whereby Pan Ocean guaranteed up to $2,880,000 of Astrodata's indebtedness to the seller of a company acquired by a subsidiary of Astrodata. In return for its guarantee, Pan Ocean received a $500,000 promissory note from Astrodata which was later exchanged for 500,000 shares of Astrodata common stock. A director of Pan Ocean owned approximately 22% of the outstanding stock of Astrodata, as well as warrants to purchase 100,000 shares of its common stock. Such director sold such 22% of the outstanding Astrodata common stock as of May 25, 1973. In addition, such director had loaned, or committed to loan, a total of $2,000,000 to Astrodata in 1973.

Effective as of March 21, 1974, a substitute guarantor replaced Pan Ocean, and Pan Ocean was in turn released from any obligations under its guarantee of up to $2,880,000. Pan Ocean had not been required to make any payments under the Astrodata guarantee prior to such release. Pan Ocean granted the substitute guarantor an option exercisable at any time between May 1, 1974 and September 30, 1979 to buy the 500,000 shares of Astrodata common stock it received in consideration for its guarantee. The exercise price of the option is $2.50 per share, which was the last reported sale price of such stock on the date the option was granted.

Pan Ocean has recorded the consideration received for its guarantee at $350,000, which represents the estimated value of the 500,000 Astrodata shares subject to the option, and has included $250,000 of such amount as income in the year ended December 31, 1973. The remaining $100,000 has been deferred and will be included in income in 1974.

Note 6—Income Taxes:

At December 31, 1973 the company had net operating loss carryovers of approximately $19,400,000 available to reduce future United States taxable income. Approximately $8,775,000 of such loss carry-overs expire in 1977 and $10,370,000 in 1978 with $255,000 expiring prior to 1977.

In 1973 the company has recorded a federal income tax credit of $183,546 relating to the carry-back of net operating losses in the United States.

At December 31, 1973 the Canadian subsidiaries had expenditures relating to drilling, exploration and lease acquisition costs of approximately $3,200,000 and capital cost allowances of $5,100,000 available to be carried forward and applied against future Canadian taxable income.

For 1973 and 1972, Pan Ocean and its United States subsidiaries have had losses before taxes. While Pan Ocean's Canadian subsidiaries had income in both years for financial statement purposes, for Canadian tax purposes these subsidiaries had expenditures related to drilling, exploration and lease acquisition costs and expenditures related to capital cost allowances available to be applied against Canadian taxes payable. Accordingly, Pan Ocean has utilized these expenditure deductions to eliminate current taxes on the reported Canadian income.

In 1972 Pan Ocean provided $140,000 for deferred income taxes representing deferred taxes applicable to timing differences in excess of the tax benefits of estimated earned future Canadian depletion allowances. In 1973 Pan Ocean, in common with many other companies in the oil and gas industry in Canada, has followed the practice of not providing for deferred taxes applicable to such timing differences. However, the Canadian provincial securities commissions have requested representatives of the oil and gas industry in Canada to undertake a study to determine whether or not income tax allocation accounting is appropriate for exploration and development expenditures including intangible costs. The securities commissions have indicated that unless the industry can justify its current practice in this regard, the industry should be prepared to adopt income tax allocation accounting for such costs in their 1974 financial statements. Had such a provision for deferred income taxes been made during 1973 a provision of approximately $810,000 would have been made, resulting in a reduction of net income per share of $.07 for such period. The accumulated Canadian income tax reductions relating to all timing differences in the current and prior years in excess of the tax benefits of estimated earned future Canadian depletion allowances amount to approximately $950,000 at December 31, 1973.

Note 7—Long-Term Debt:

Long-term debt includes the following:

	December 31, 1973	1972
Convertible subordinated note, due July 1, 1985 with interest at 8%	—	$10,000,000
Secured bank loan, at ½% over Canadian prime rate	$4,876,779	5,920,467
Notes payable to banks	1,200,000	1,500,000
Promissory note due August 9, 1975 with interest at 8%	120,000	—
	6,196,779	17,420,467
Less—Estimated amounts to be paid within one year included in current liabilities	2,460,000	1,582,600
	$3,736,779	$15,837,867

During 1970 the company received from Pioneer Lands Corporation $10,000,000 cash for an 8% convertible subordinated note which was convertible into common stock of the company at $12.50 per share. Pioneer Lands and certain of its affiliated companies and individuals at that time owned approximately 50% of the outstanding common stock of Pan Ocean. The note was fully converted in 1973 and 800,000 shares were issued to a present shareholder of the company, who obtained title to the note upon the liquidation of Pioneer Lands Corporation in 1970.

The bank loan of $4,876,779 is secured by assignments of interests in certain Canadian hydrocarbon reserves. The term of repayment is not to exceed seven years. The company estimates that approximately $1,200,000 of the loan will be repaid during 1974.

In March 1974, the company paid $1,000,000 of the note payable to a bank and the balance of $200,000 is payable on April 30, 1974 with interest currently at 9.85%.

Note 8—Common Stock and Stock Option Plan:

On August 22, 1969, pursuant to a Stock Purchase Agreement dated as of May 31, 1969 between the company and an officer, the company issued 60,000 shares of common stock for $160,000 in cash. In connection with this transaction, the company on August 25, 1969 loaned such officer $160,000 with interest at 7% per annum to be repaid in equal instalments on June 1, 1971, 1972 and 1973. During 1973 the final principal payment of $53,333 due on the loan was made.

The company has a qualified stock option plan, ratified by the shareholders on March 5, 1969, to grant options for up to 300,000 shares. At December 31, 1973 options for 250,000 shares have been granted of which options for 180,000 shares have been exercised. On December 11, 1970, shareholders ratified a new plan to grant options to purchase up to 75,000 shares, of which options for 40,000 shares have been granted as of December 31, 1973. Both plans provide for the purchase of stock at 100% of its fair market value as of the date the option is granted. Options may not be exercised under either plan unless the grantee remains in the employ of the company for one year after the date of grant. The options expire up to five years from the date of grant.

During 1972 options have been granted to directors and employees of the company who are foreign nationals to purchase 43,000 shares at option prices ranging from $10 to $16. During 1973 options have been granted to directors and employees of the company who are foreign nationals to purchase 12,000 shares at option prices ranging from $14-$15¼. Also during 1973 a nonqualified option for 10,000 shares at $15⅞, the fair market value at date of grant, was issued to a nonemployee. The options expire up to five years from the date of grant. The terms of an outstanding stock option for 50,000 shares, granted to an officer and director, were modified, including a change in the form of option from qualified to nonqualified. This option was exercised as to 40,000 shares.

The agreement whereby Pan Ocean merged with Dynamic provided that stock options held by Dynamic employees at December 22, 1971 be assumed by Pan Ocean. During 1972 options have been granted under this plan to purchase 16,774 shares at an option price of $9.44 per share and 647 shares at an option price of $8.65 per share. Also during 1972 options to purchase 2,658 shares were exercised at option prices ranging from $8.65 to $9.44 per share and options to purchase 1,209 shares were cancelled. During 1973, options to purchase 2,733 shares have been exercised at $9.44 per share and options to purchase 819 shares were cancelled. The options expire up to four years from the date of grant.

Transactions under the company's stock option plans and other options granted are summarized as follows:

	Number of Shares	Option Price
Shares under option at December 31, 1973	335,502	$8-$19-1/8
Options which became exercisable in 1973	126,829	$9.44-$16
Options exercised in 1973	61,733	$8-$12

Of the 335,502 shares, options for 146,829 shares were exercisable at December 31, 1973 and options for 56,693; 47,943; 26,375 and 18,000 shares become exercisable in the years 1974 through 1977, respectively:

The excess of proceeds over par value of shares issued under stock options is credited to capital in excess of par value.

Note 9—Extraordinary Item:

Gain on sale of developed properties:

Included in the acquired properties described in Note 1 were certain natural gas wells and related facilities in Crockett County, Texas (acquired during 1969 and 1970). This acquisition was undertaken to establish a basis for future cash flow and was not considered part of the company's normal operations. The net assets received were recorded at their estimated fair value based on an independent appraisal engineer's projection of future cash flow discounted at 8%. Certain shareholders of the company held significant interests in the Texas properties prior to their acquisition by Pan Ocean.

During 1971 these Texas properties demonstrated increasingly disappointing performances. The wells failed to respond to stimulation and performance continued to decline. Consequently, a new reserve study was commissioned and the report was received in February 1972. The study indicated that the previously estimated reserves required a significant downward adjustment and, accordingly, the properties were written down in value in 1971 by $8,757,273 to their estimated remaining residual value of approximately $1,200,000.

In August 1973 Pan Ocean sold these properties for an aggregate of $2,200,000, consisting of $350,000 cash and promissory notes of $1,850,000 with interest at 8%. At December 31, 1973 $1,400,000 of these notes were outstanding. In February 1974, Pan Ocean received $1,400,000 in cash plus accrued interest as a final payment for the promissory notes.

Note 10—Earnings Per Share:

Per share amounts are based on the average number of common shares outstanding during each year adjusted for the assumed exercise of all dilutive stock options computed by the application of the "treasury stock" method. For 1973 the weighted average number of common shares issued upon conversion of the $10,000,000 convertible note have also been included in the per share computation. Accordingly, the number of shares used in the per share computations for 1973 and 1972 were 11,433,829 and 10,614,538, respectively.

Fully diluted per share amounts have not been presented since the assumed conversion of the convertible note would have an antidilutive effect for 1972 when such note was outstanding.

Note 11—Commitments and Contingencies:

Commitments:

The company has various obligations to governments in the form of exploratory work programs and cash payments in order to retain the rights to the acreage it holds. In addition, it has obligations to contribute its share of budgeted expenses agreed to under joint venture agreements relating to exploratory work. At December 31, 1973 these obligations amounted to approximately $18,000,000 for 1974 and $5,200,000 for 1975. Also if certain exploration programs prove successful, Pan Ocean may have substantial additional expenditures for development wells and production facilities.

The company has leases for office space through 1980 at a yearly current rental of approximately $425,000 which is net of sublet rentals of approximately $228,000. Rental payments for 1973 and 1972 amounted to approximately $417,000 and $337,000, respectively.

Contingencies:

Pan Ocean is both a general and limited partner of a limited partnership that committed, in July 1972, to spend $17 million in a four-year joint exploration program with another oil company. To the extent that such partnership commitment is not met by limited partners' contributions, Pan Ocean is obligated to make up the deficiency. In 1972 and 1973 the limited partners, other than Pan Ocean, some of whom are directors and officers of the company, contributed approximately $5.3 and $3.4 million, the amount budgeted for program expenditures for those years, respectively. An additional $2.7 million was subsequently contributed by Pan Ocean because of an excess of program expenditures over budgeted costs. The 1974 budget calls for program expenditures for approximately $3.7 million, all of which the company believes will be contributed by limited partners other than Pan Ocean.

In 1971 the Canadian Department of National Revenue issued notices of reassessment disallowing certain deductions claimed by The Dynamic Group of Companies in arriving at taxable income for its 1966 and 1967 fiscal years with the result that income taxes and interest totaling $234,165 have been paid. The company believes that the reassessments are without merit and is contesting them. Accordingly, the income taxes and interest paid have not been shown in the accompanying statements of income and the payments have been included in other assets at December 31, 1973 and 1972.

The company is a party to certain derivative actions. In the opinion of the company and its legal counsel such litigation will have no material adverse effect on the accompanying financial statements. The company has no knowledge of any other litigation of tax or other claims pending or considered likely or any other contingent liabilities of any important consequence.

Report of Independent Accountants

To the Shareholders and the
Board of Directors of
Pan Ocean Oil Corporation

In our opinion, the accompanying consolidated balance sheets and the related statements of consolidated income and deficit and the statements of common stock and capital in excess of par value and of changes in financial position present fairly the financial position of Pan Ocean Oil Corporation and its subsidiaries at December 31, 1973 and 1972, the results of their operations and the changes in financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied. Our examinations of these statements were made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

60 Broad Street
New York, N.Y.
March 29, 1974

Price Waterhouse & Co.

Pan Ocean Oil Corporation

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