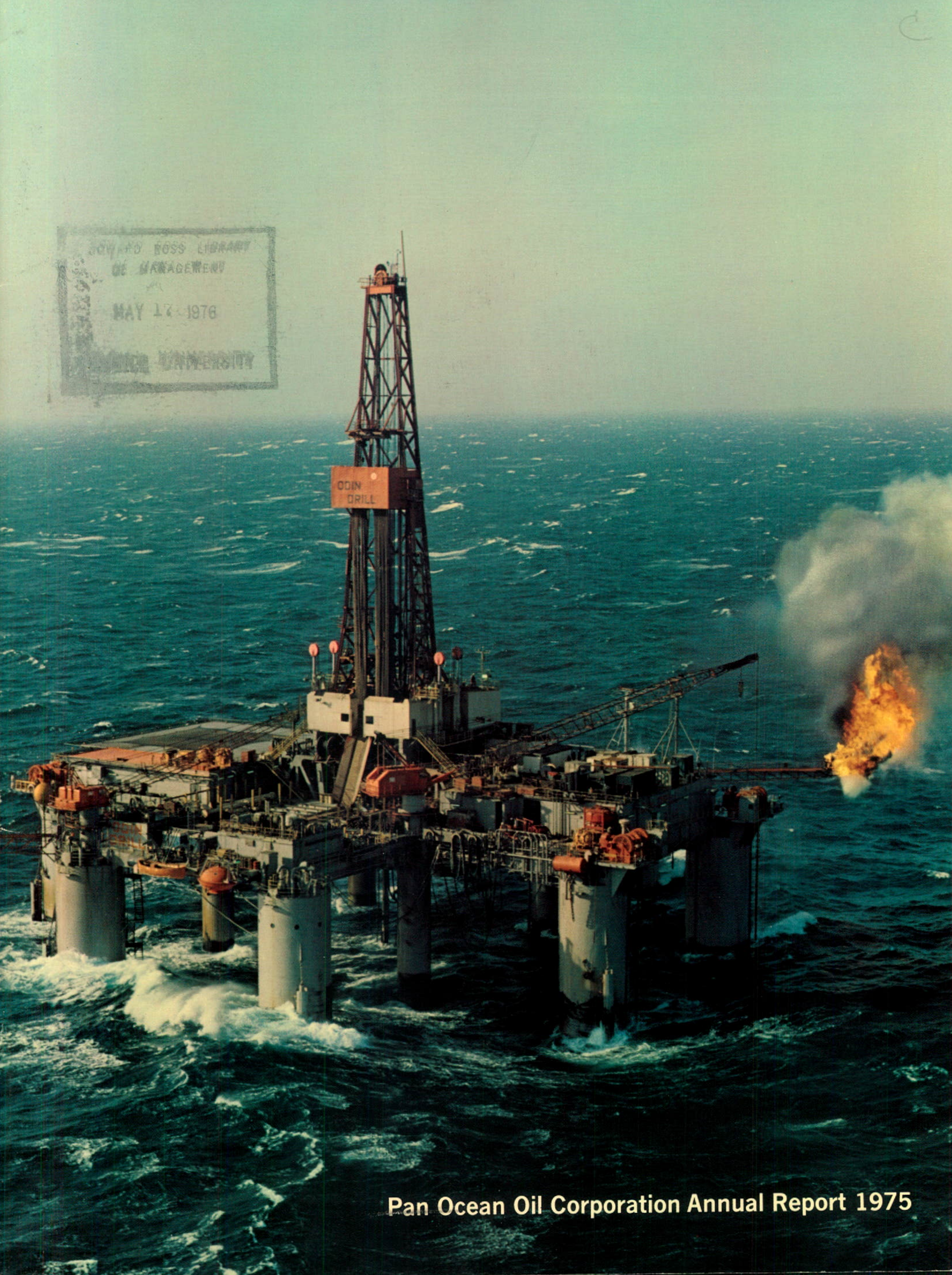


Pan Ocean Oil Corporation Annual Report 1975

To our Shareholders

We are pleased to bring you our seventh Annual Report.

The business of Pan Ocean is the exploration, development and production of oil, gas, uranium, coal and other mineral resources. From a small initial base, the Company in a relatively short period of time has established substantial interests in major reserves—diversified both as to energy form and geographical location.

One of the Company's most significant corporate developments to date is the discovery and recent appraisal drilling of the Brae Field in the U.K. North Sea. The combination of a thick vertical accumulation of Jurassic sandstone within a stratigraphic and structural trap of extensive areal dimension, indicates that Brae could well be one of the larger oil fields in the U.K. North Sea. The discovery well, completed in May of last year, encountered approximately 500 feet of gross pay section. The appraisal well, completed in March of 1976, was drilled four miles away and encountered approximately 1,000 feet of gross pay section. Additional appraisal drilling will be required to establish total recoverable reserves.

Pan Ocean appraisal well, 16/7-3, being flow tested in the Brae Field in the U. K. North Sea.

A second oil discovery was made by Pan Ocean on Block 16/7 in August of last year. This well tested 4,023 barrels per day from a 90-foot Paleocene sandstone section five miles west of the Brae discovery well.

Pan Ocean Oil Corporation

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

Dear Shareholder:

On April 2, 1976, subsequent to the preparation of this 1975 Annual Report, Pan Ocean Oil Corporation and Marathon Oil Company jointly announced an offer by Marathon to purchase any and all shares of Pan Ocean common stock for cash at $18.00 (U.S.) net per share.

On April 15, 1976, Marathon issued the following press release:

> "Marathon Oil Company announced today that its wholly owned subsidiary, Marathon Energy, Ltd., has now acquired stock or stock equivalents representing more than 50% equity interest in Pan Ocean Oil Corporation.
>
> On April 2, Marathon Energy offered to purchase any and all shares of Pan Ocean common stock for cash at $18 (U.S.) per share. The tender offer is scheduled to expire at 5:00 P.M., E.S.T. on April 23, 1976.
>
> If Marathon Energy is successful in acquiring all outstanding Pan Ocean shares, the transaction would total approximately $260 million."

Although the Pan Ocean Board of Directors has not made any recommendation concerning the offer to other stockholders, all of the directors of Pan Ocean have sold or tendered their Pan Ocean shares to Marathon at $18.00 per share.

Sincerely,

Stanley R. Rawn, Jr.

Stanley R. Rawn, Jr.
Chairman of the Board

April 15, 1976

An oil discovery made by Pan Ocean onshore Nigeria has undergone an intensive development program during the past year. Oil production is expected to commence by mid-1976 and should generate a substantial increase in income to the Company in the current year.

A fourth successful well was drilled last year in the Arzanah Field offshore Abu Dhabi in the Arabian Gulf. A contract for the design and engineering of the production facilities has been awarded and production from the Field could begin late next year.

A successful appraisal well was drilled during 1975 in the Heimdal Gas Field in the Norwegian North Sea and a gas sales contract was concluded with the British Gas Corporation. However, a decision to file the application with the Norwegian Government for the landing of Heimdal gas in the U.K. was deferred in January of this year until further studies have been completed. This will likely delay the planned development schedule which had called for gas sales to begin in 1980.

Production of uranium oxide from the Rabbit Lake mine/mill complex in Canada began in mid-1975 and is now expected to develop significant income to Pan Ocean's net profits interest commencing in 1978. This is the largest single uranium mine/mill operation in North America.

A detailed feasibility study on the development of the Sage Creek metallurgical coal properties in Canada was completed last year. Ongoing engineering and marketing studies should lead to a decision to commence construction early next year with coal sales expected to commence in 1980.

Operating revenues increased from $9,525,833 in 1974 to $11,387,115 in 1975. Net income increased only slightly, however, from $598,508 or $.05 per share, before an extraordinary item in 1974, to $680,078, or $.06 per share in 1975. Interest costs were significantly higher in 1975 as a result of a net $25 million increase in bank loans during the year and the placement of $15 million of 7.5% convertible subordinated notes. Expenditures for drilling and development increased from $24 million in 1974 to $44 million in 1975. The major part of the 1975 expenditures was devoted to the development of the Ogharefe Oil Field in Nigeria and the drilling of four successful wells in the North Sea. Drilling and development expenditures for 1976 are budgeted to be $26 million.

The Company's successful exploration during the past several years has created a number of large development projects. The first of these, the Ogharefe Oil Field in Nigeria, is about to be completed on schedule and within budget. Other projects are staggered over the next five years, and it is not unlikely that future exploration may result in additional new development projects during that period. This is an ambitious program and will require well-planned corporate and project financing as these reserves are developed and brought into production.

The past year, although highlighted by the exploration success in the North Sea and the development program in Nigeria, was marked by important progress in a number of other activities which are briefly described in the following pages of this Report. We wish to express our appreciation again this year to the people of Pan Ocean for their performance and dedication, and to thank our more than 20,000 shareholders for their continued support.

Stanley R. Rawn, Jr.

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

March 25, 1976

Oil and Gas Exploration

Flow test in progress on a Pan Ocean well in the Brae Field in the U. K. North Sea.

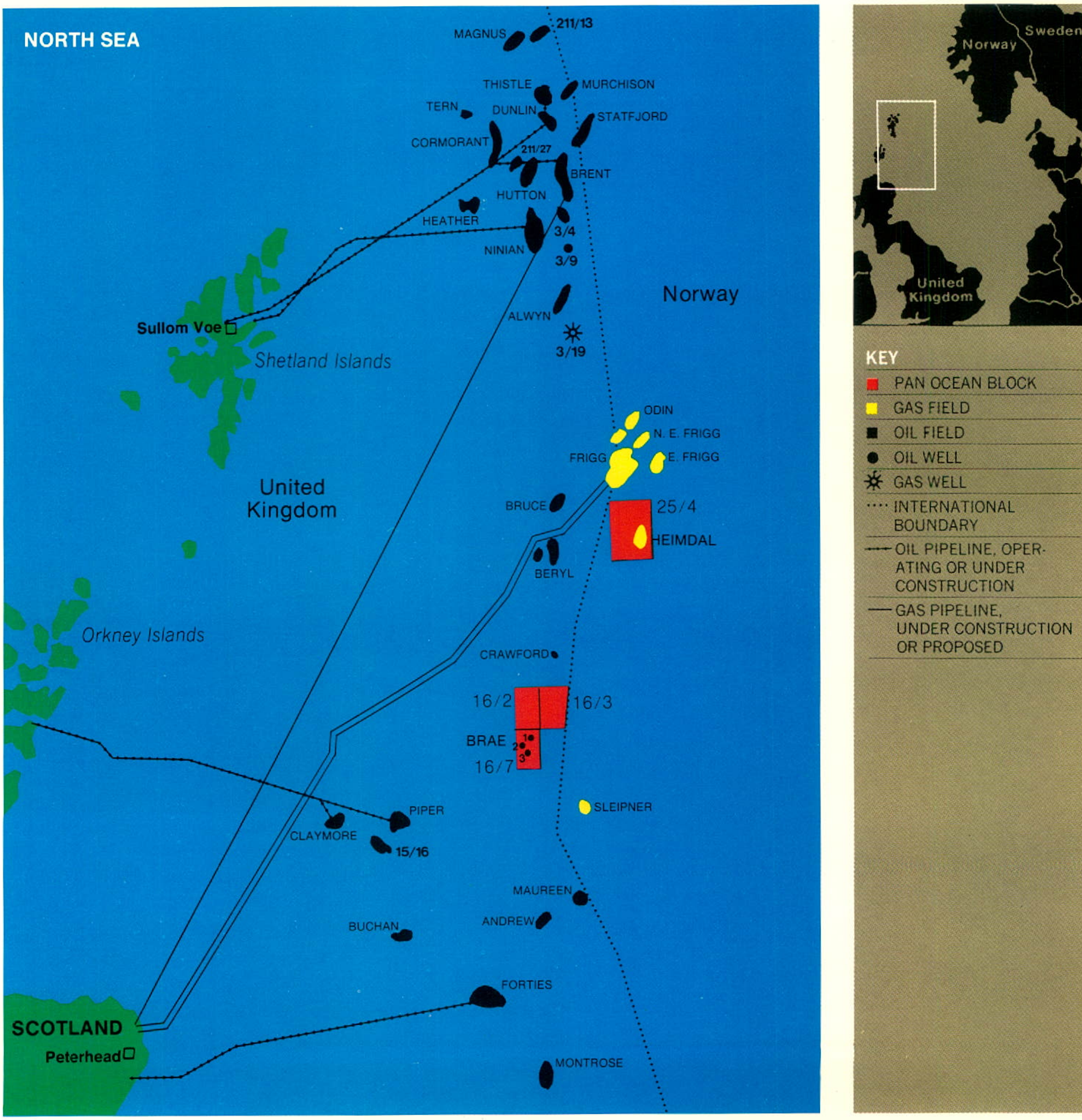
During the past year, Pan Ocean completed the drilling of three successful wells on Block 16/7 in the **U. K. North Sea.** The first well resulted in a deep Jurassic discovery which is now known as the Brae Field. The second well discovered oil in a Paleocene feature, separate from the Brae Field and at a shallower depth. The third and most recent well was a long step-out, or appraisal well, drilled in the Brae Field which encountered an oil reservoir that had twice the thickness of the reservoir found in the Brae discovery well. Pan Ocean holds interests and acts as operator in the three contiguous blocks, 16/7, 16/3 and 16/2.

The first discovery well, 16/7-1, which was announced in April 1975, encountered a continuous gross hydrocarbon section of 500-foot thickness at a depth of approximately 12,000 feet. Results of stabilized flow tests through restricted chokes varying from one-half inch to one inch in size from seven selected intervals within the section totaled over 22,000 barrels per day. The oil gravity ranged from 35 degrees API with a gas-oil ratio of 3,000 cubic feet per barrel in the lower part of the pay zone up to 46 degrees API with a gas-oil ratio of about 7,000 cubic feet per barrel in the top part of the zone.

The discovery was named the Brae Field and is located 143 miles northeast of Peterhead, Scotland. The water depth is 340 feet. The discovery has been made on an unusually large geological feature of Jurassic age and will require a number of appraisal wells before an accurate determination of oil and gas reserves can be made.

On October 9, 1975, the first appraisal well on the Brae Field was commenced at a location four miles southwest of the discovery well. This appraisal well, 16/7-3, encountered approximately 1,000 feet of continuous gross hydrocarbon section. Flow tests through a one inch choke from four selected intervals totaled 13,939 barrels per day. The oil gravity averaged 36 degrees API and the gas-oil ratio was approximately 1,600 cubic feet per barrel. Seismic evidence indicates that the Brae Field could extend into Blocks 16/2 and 16/3 to the north. Additional drilling will be required to confirm this.

In July 1975, Pan Ocean drilled its second exploratory well on Block 16/7, five miles west of the Brae discovery,


NORTH SEA
MAGNUS
211/13
THISTLE
MURCHISON
TERN
DUNLIN
STATFJORD
CORMORANT
211/27
BRENT
HUTTON
HEATHER
3/4
NINIAN
3/9
Norway
ALWYN
Sullom Voe
3/19
Shetland Islands
ODIN
N. E. FRIGG
FRIGG
E. FRIGG
United Kingdom
BRUCE
25/4
HEIMDAL
BERYL
Orkney Islands
CRAWFORD
16/2
16/3
BRAE
1
2
3
16/7
PIPER
SLEIPNER
CLAYMORE
15/16
MAUREEN
BUCHAN
ANDREW
FORTIES
SCOTLAND
Peterhead
MONTROSE
Norway
Sweden
United Kingdom
KEY
PAN OCEAN BLOCK
GAS FIELD
OIL FIELD
OIL WELL
GAS WELL
INTERNATIONAL BOUNDARY
OIL PIPELINE, OPERATING OR UNDER CONSTRUCTION
GAS PIPELINE, UNDER CONSTRUCTION OR PROPOSED

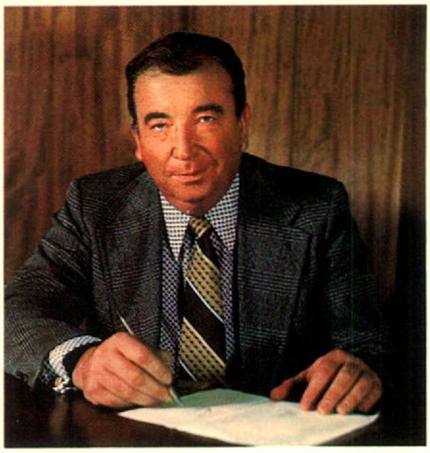
in order to test a shallow Paleocene feature. This well, 16/7-2, encountered a 90-foot hydrocarbon sand section at a depth of approximately 6,000 feet. A 30-foot perforated interval within the section tested oil at a rate of 4,023 barrels per day through a one inch choke. The gas-oil ratio was 252 cubic feet per barrel and the oil gravity was 23 degrees API. A preliminary engineering study indicates an attractive economic rate of return might be realized by developing and producing this smaller field from a floating production platform. This would have the advantage of bringing the field into production at a much earlier date than would be possible if its development were to await the installation of a platform on Brae. A decision whether to utilize a floating production platform for this discovery is expected during 1976.

In September 1975, the British National Coal Board exercised its option to acquire a 20% working interest in Blocks 16/7 and 16/3 following Pan Ocean's declaration of commerciality for the Brae Field. The option had been provided for in the license, dated July 29, 1970, covering the two blocks. In accordance with the license terms, the Coal Board reimbursed the Company $1.8 million representing Pan Ocean's share of previous expenditures attributable to the 20% interest. Exercise of the option has reduced Pan Ocean's interest in Blocks 16/7 and 16/3 to 32%. In January 1976, the Coal Board became a subsidiary of the British National Oil Corporation. Pan Ocean continues to have a 40% interest in Block 16/2 with respect to which there is no Coal Board option to acquire an interest. The drilling of the 16/7-2 well fulfilled all the drilling requirements of the licenses covering Blocks 16/7, 16/3 and 16/2.

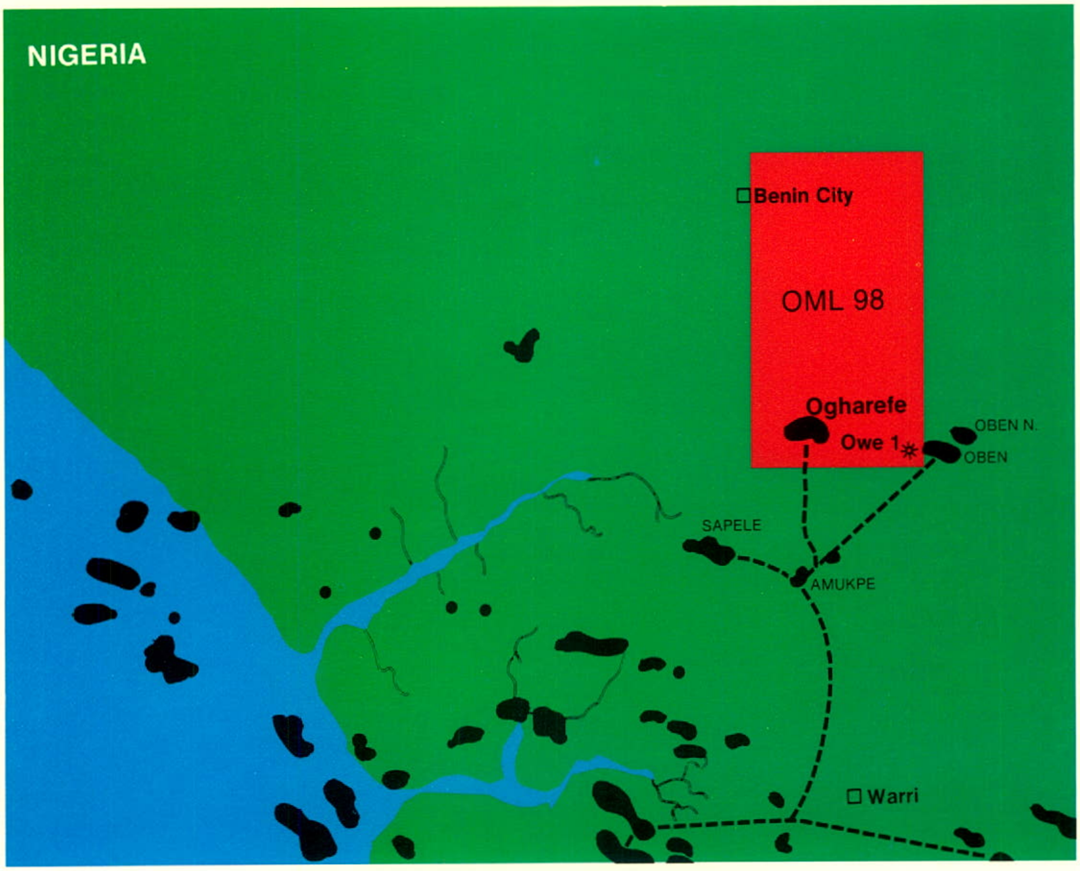
In the **Norwegian North Sea,** a successful appraisal well was drilled during 1975 in the Heimdal Field, a gas-condensate field discovered by the Pan Ocean-Petronord group in 1972. The well, which was drilled two miles north of the discovery well, encountered 110 feet of gas sand which confirmed the seismic prognosis for this location. Statoil, the Norwegian state-owned oil company, exercised its option to acquire a 40% working interest in the Heimdal Field on May 2, 1975, which reduced Pan Ocean's interest in the Field to 19.375%.

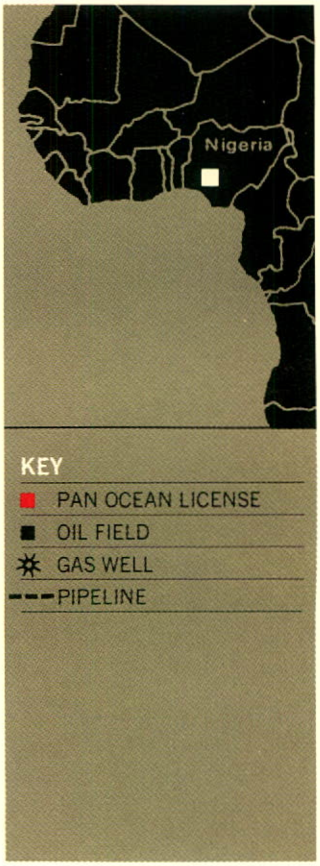
Pan Ocean-Petronord appraisal well, 25/4-4, being drilled during 1975 in the Norwegian North Sea.

A contract was signed in September 1975 for the sale of Heimdal gas to the British Gas Corporation. The previous time schedule had called for filing an application during January 1976 with the Norwegian Government to export the gas to the United Kingdom. However, a decision was made during January to defer filing the application pending further economic and technical studies. It is expected that Heimdal gas will be transported through the Frigg pipeline system to Peterhead, Scotland, and negotiations with respect to a pipeline tariff have commenced. Elf Norge, a subsidiary of ERAP/Elf, the French state-owned company, is operator for both the Frigg Field and the Heimdal Field. The Frigg Field is located 22 miles north of the Heimdal Field and is expected to commence gas deliveries in 1977.



F. William Popp
Executive Vice President of the Company, responsible for Pan Ocean's international oil and gas operations.





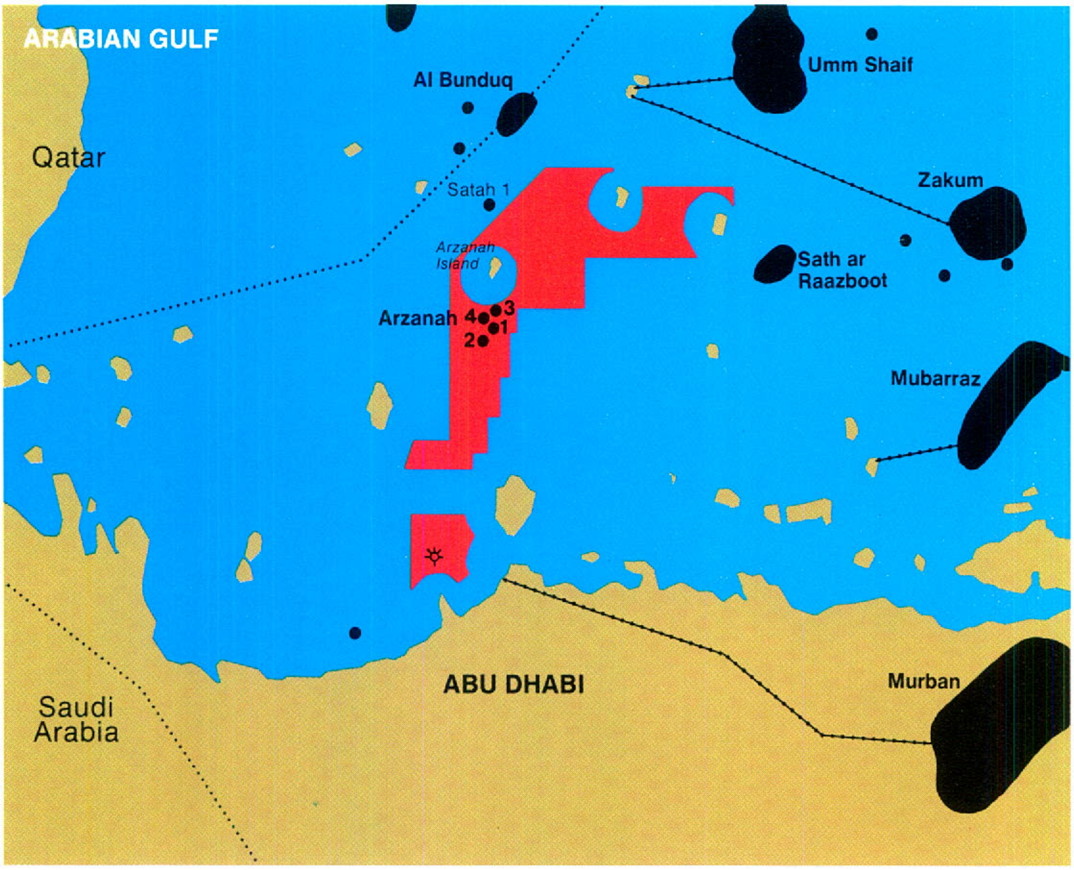
Development of the Ogharefe Field onshore **Nigeria** has proceeded on schedule and oil production is expected to commence during the second quarter of this year. The Ogharefe Field was discovered by Pan Ocean in November 1973. The Ogharefe No. 1 well tested a total of 8,000 barrels per day from several high pressure sands with high gas content. In January 1975, a subsequent well, Ogharefe No. 3, tested an aggregate of 14,674 barrels per day of low-sulphur, high-gravity oil, from three sands located above the productive zones tested in the first well. These upper sands have normal pressures and lower gas-oil ratios, and consequently are being developed first. Six development wells have now been completed in the upper sands and a seventh well is currently drilling. Eventual production rates will be determined by government allowables and the ultimate number of development wells drilled in the Field. Production facilities at the Ogharefe flow station are in an advanced stage of construction and a 13-mile pipeline is presently being laid to a connecting pipeline terminal.

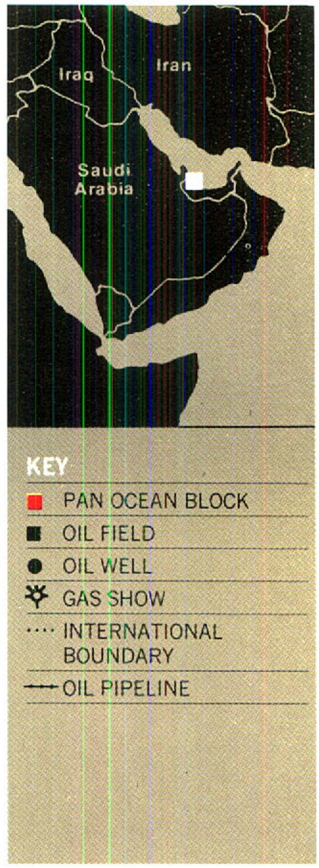
Seismic studies have confirmed the existence of several additional structures within the license area, two within a five-mile radius of the Ogharefe Field. Accordingly, during 1976, the Company plans to do exploratory drilling as well as continued development drilling in the Ogharefe area.

On November 1, 1975, the Nigerian Ministry of Petroleum converted Pan Ocean's 248,000 acre Oil Prospecting License (O.P.L.) 71 into Oil Mining Lease (O.M.L.) 98. The OML, which is a production license, was granted in both the name of Pan Ocean Oil Corporation (Nigeria), as 100% working interest holder, and our Nigerian partner, Delta Oil (Nigeria) Ltd., as a royalty interest holder.

Production well being drilled in the Ogharefe Field in Nigeria, with flow station under construction in the background.

Pipelines being laid from a production well to the flow station in the Ogharefe Field in Nigeria.





The Arzanah Oil Field, offshore **Abu Dhabi,** was discovered in December 1973 at a location six miles south of Arzanah Island in the Arabian Gulf. The discovery well tested in excess of 4,000 barrels per day of 45 degree API oil. Successful confirmation wells were drilled three miles south and one-and-one-half miles north of the discovery well in 1974 and early 1975. A fourth well in the Arzanah Field tested a total of over 10,000 barrels per day from two zones in November 1975. The water depth is approximately 50 feet. A contract has been awarded for the design and engineering of production facilities for the Field. Two additional development wells are planned, to bring the total number of wells in the Field to six. Production is expected to commence toward the end of next year.

In December 1975, an oil discovery was made by another group two miles north of Pan Ocean's concession boundary and nine miles north of Arzanah Island. Seismic results suggest the new field, which has been named the Satah Field, extends into our concession area. The Company and its partners are considering the drilling of a test well during 1976 on the portion of this structure which extends into the Company's concession area. Additional exploratory drilling in the concession area is also under consideration. Pan Ocean holds a 31.5% interest in the Abu Dhabi concession and Amerada Hess Corporation is the operator.

In January 1976, after drilling four unsuccessful exploratory wells, Getty Oil Company, as operator, relinquished Block 3 in the Amazon Basin of **Peru,** in which Pan Ocean had held a 25% interest. The Amazon Basin, which had

Well being tested in the Arzanah Field
offshore Abu Dhabi in the Arabian Gulf.

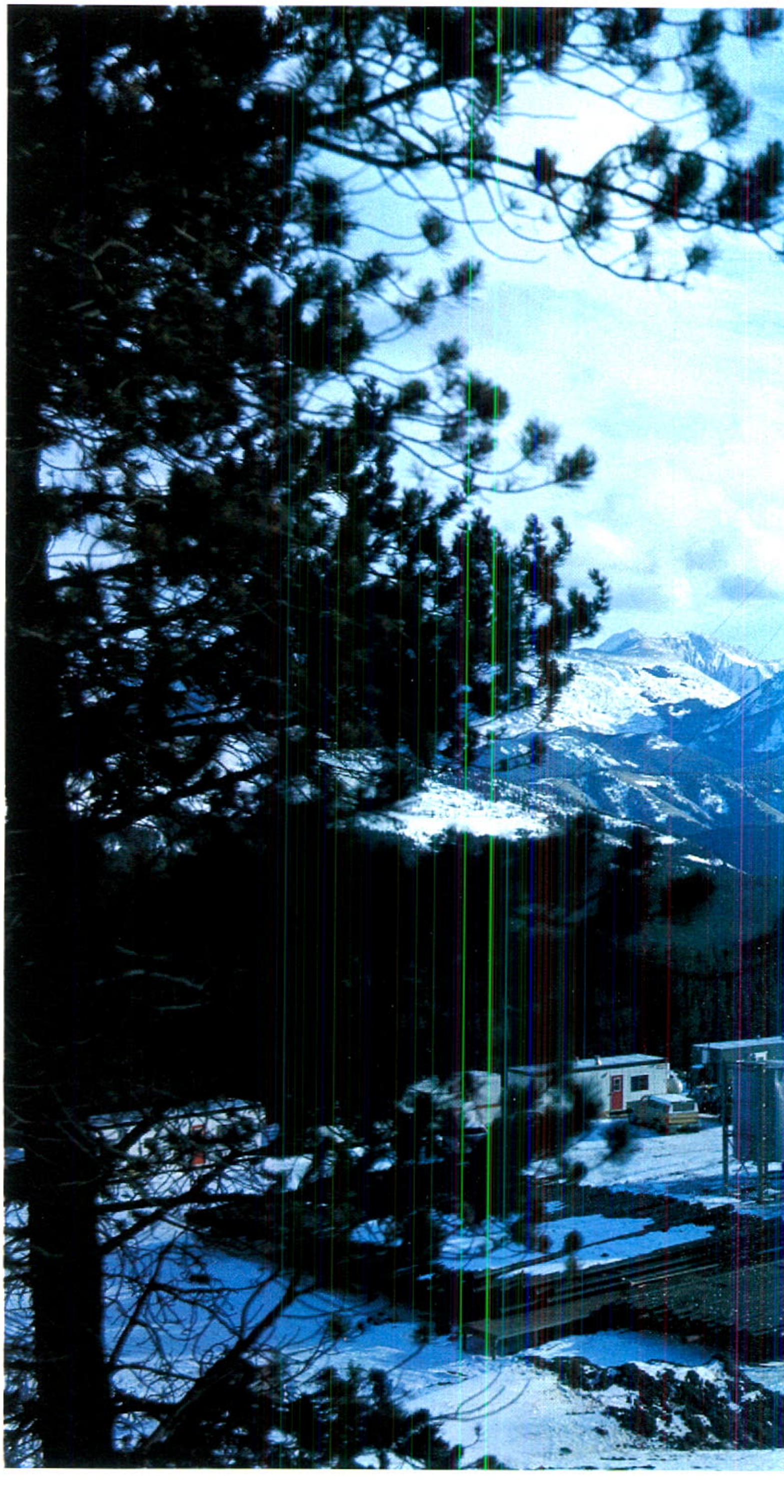
attracted the efforts of a large number of major international companies over the past four years, had high potential as an important new oil basin. Unfortunately, the potential failed to be realized and most of the blocks there have now been relinquished.

In **Indonesia** Pan Ocean holds a 35.1% interest in a Production Sharing Contract covering 7.9 million acres offshore Sumatra. No commercial hydrocarbons have as yet been encountered in the six test wells drilled to date. A number of prospective features remain to be tested in the contract area, and further exploratory drilling is under consideration. Atlantic Richfield Company is the operator.

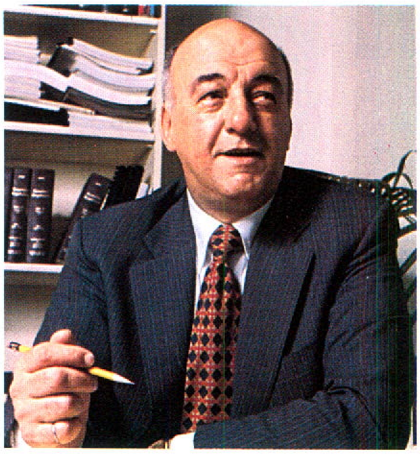
The Company has various exploratory interests ranging from 3.9% to 7.1% in approximately 22 million acres in the **Republic of the Maldives,** located in the Indian Ocean. Over 4,000 miles of seismic surveys have been carried out. The first test well was drilled and abandoned in February of this year. ERAP/Elf is the operator.

As a result of an improving price structure for gas and oil in **Canada,** together with recent improvements in the tax and royalty situation there, exploration in Canada, particularly for deeper foothills gas in Alberta, made a significant turnaround last year. This is apparent in the substantially higher prices now being paid for exploration acreage, especially in the Alberta foothills, as well as in the current upswing in Canadian drilling activity. Industry forecasts indicate exploration expenditures in Canada will increase by 25.1% in 1976 compared with only 1.6% for the U.S.

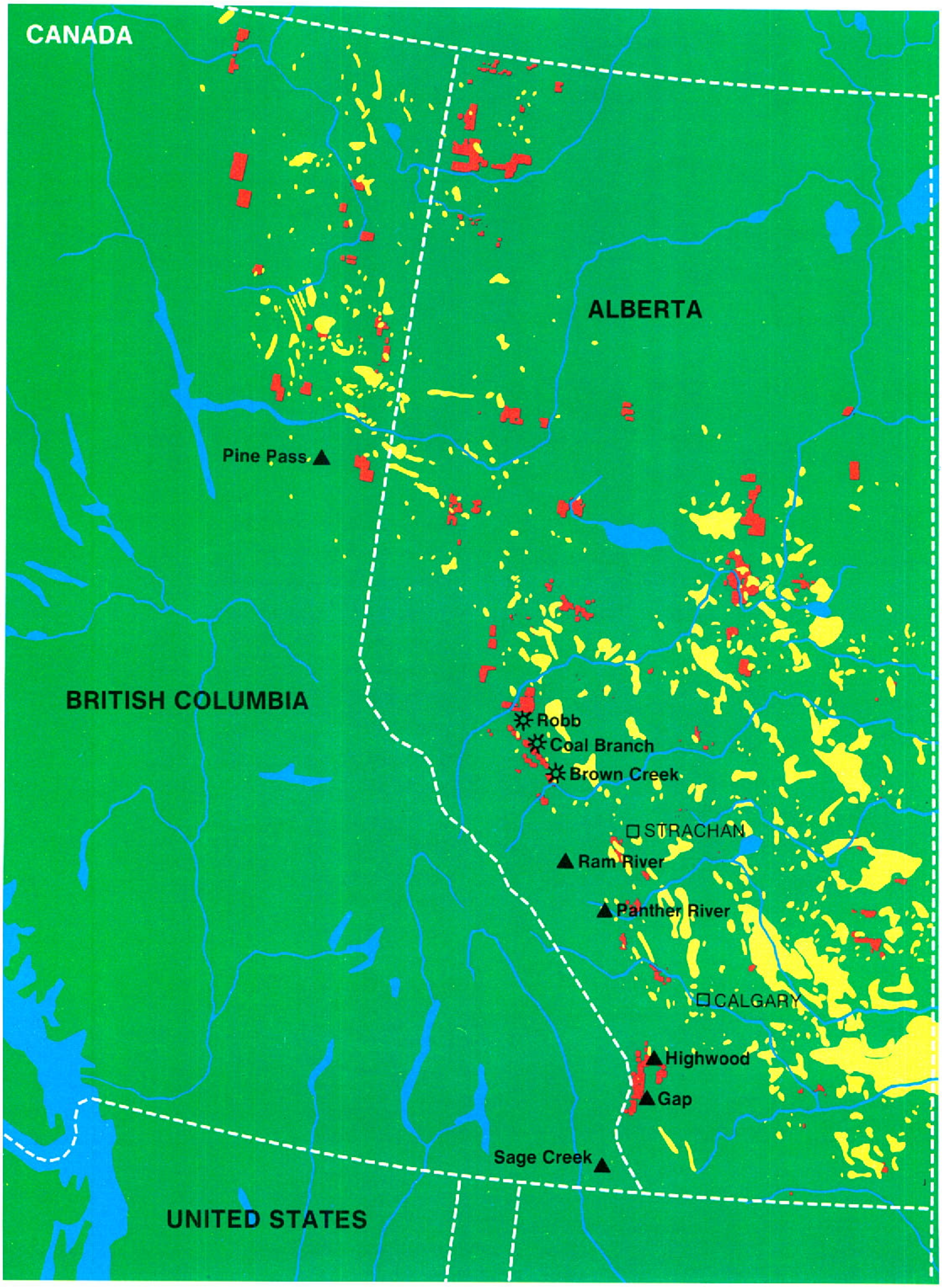
The terms of a $21.5 million four-year joint exploration program with Gulf Oil Canada Limited were fulfilled on September 1, 1975, and Pan Ocean has now earned 25% of the interest of Gulf Oil Canada in 1.5 million gross acres of prospective land in Alberta and British Columbia. Pan Ocean was responsible for $17 million of drilling which was provided principally by individuals through a limited partnership arrangement. Under the partnership arrangement revenues after payout from discoveries made during the four-year program are to be divided equally between the limited partners and Pan Ocean. Pan Ocean is responsible for the limited partners' portion of development costs

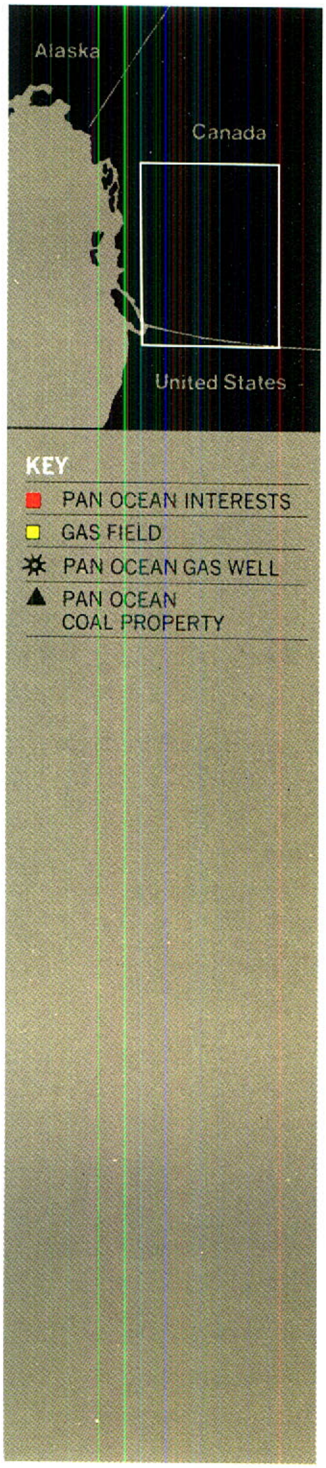


Pan Ocean-Gulf exploratory well being drilled in the Gap area of the Alberta foothills.



Alaster G. Swanson
Vice Chairman of the Company and
responsible for Pan Ocean's world wide
mineral operations.





associated with these discoveries. Upon termination of the four-year program, the limited partners retain an interest in only that acreage which is deemed capable of production as a result of exploratory drilling during the program. Pan Ocean not only retains its partnership interest in this acreage, but also is entitled to 25% of Gulf Oil Canada's interest in all of the acreage which was not tested in the program.

A total of 116 wells have been drilled on the venture lands during the term of the Gulf-Pan Ocean joint exploration program, which resulted in 48 gas wells and 2 oil wells. A final deep foothills exploratory well is currently drilling in the program in the Gap project area of Alberta. Results from this well are not expected to be available before May.

An active exploratory and development drilling program has been proposed by Gulf on the joint venture acreage during 1976. Present proposals call for the drilling of over 20 wells in the current year, including three deep foothills wells, in addition to completing and testing of two foothills discoveries made during the four-year program.

In December 1972, Panarctic Oils Ltd. earned one-half of Pan Ocean's 25% interest in a 60,749 acre block offshore Melville Island in the Arctic by drilling an onshore exploratory well 1.5 miles east of the block. The well resulted in the discovery of the Hecla Gas Field. In April 1974, an offshore exploratory well, drilled from a floating ice platform, confirmed an eight-mile westward extension of the Hecla Gas Field across our block. This well was drilled 1.5 miles west of the block. In February 1976, Panarctic drilled a well one mile further west and discovered a deeper gas sand in the Hecla Field. A new delineation well is now being drilled seven miles further to the northwest from another floating ice platform. The Hecla and Drake Point gas fields, both on Melville Island, are the two largest gas fields that have been discovered in the Arctic Islands. Although the successful drilling program at Hecla moves Arctic exploration considerably closer to the establishment of commercial reserves, the timing of any market realization of Arctic gas is not yet known.

The Company's principal producing property is located in the **Strachan** area of west central Alberta where Pan Ocean has a 20.18% working interest in the Strachan Leduc D-3 Gas Unit No. 1 operated by Gulf Oil Canada Ltd. This unit has four producing gas wells and a gas processing plant designed for 275 million cubic feet of gas per day. The plant recovery is approximately 6,500 barrels per day of condensate, 4,000 barrels per day of mixed propane and butane and 775 long tons per day of sulphur. Substantial quantities of sulphur have been produced and stockpiled at the plant, and the Company's share of such stockpiled sulphur is now approximately 260,000 long tons. A railroad spur line for sulphur transportation was completed in January 1976; however, no sulphur sales have commenced due to a softening of the sulphur market during late 1975. Negotiations are currently in progress, both with respect to the sale of liquid sulphur and stockpiled sulphur.

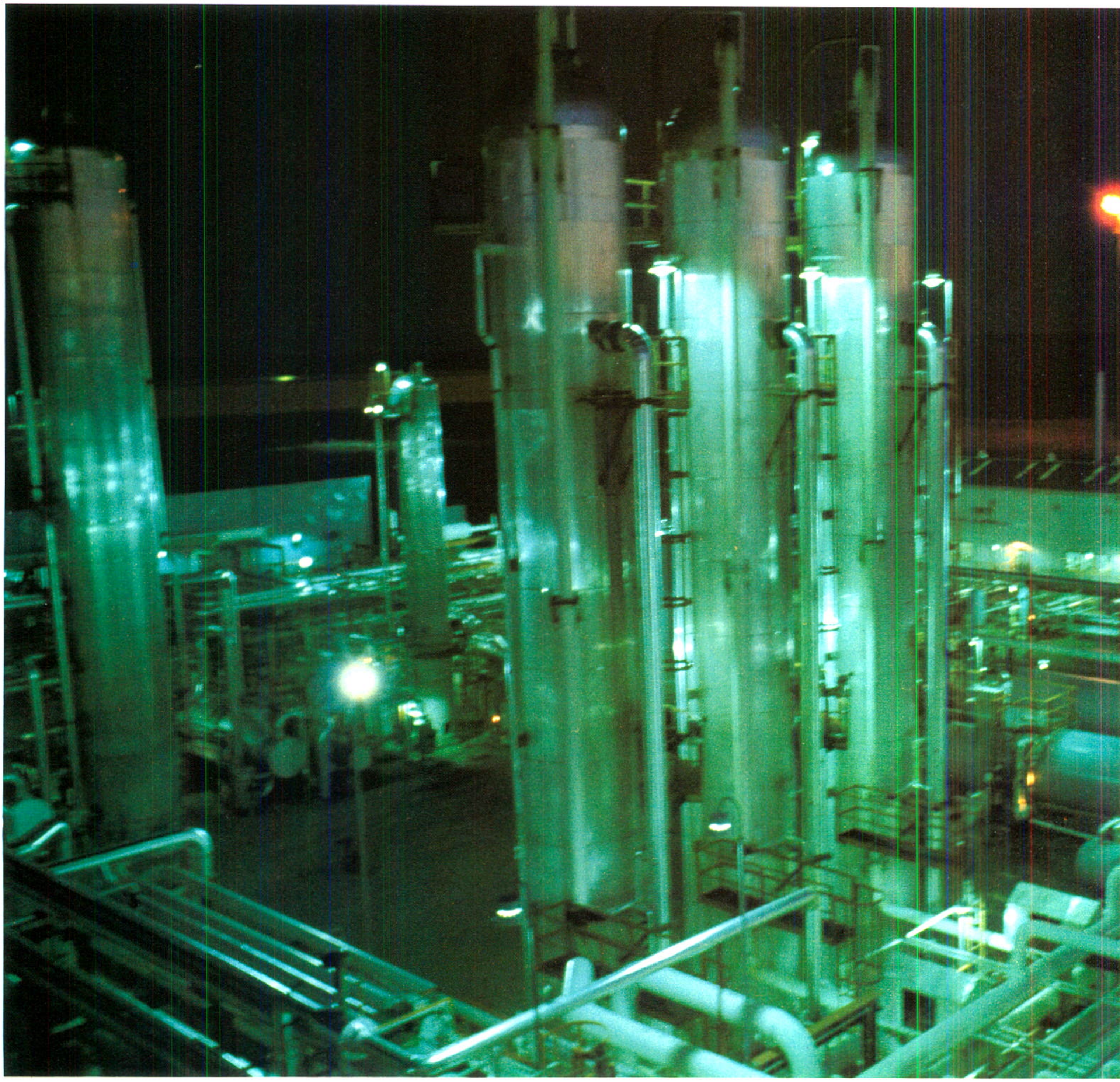
Minerals

Uranium

Production of uranium oxide (U_3O_8) commenced in July 1975 at the mine and mill complex located at Rabbit Lake, **Saskatchewan,** which is operated by Gulf Minerals Canada Limited, a subsidiary of Gulf Oil Corporation. Pan Ocean has an 8.75% interest in the net profits of the operation after certain exploratory costs are recovered by Gulf Minerals. This interest increases to 17.5% of net profits after recovery by Gulf Minerals of all development costs. Discovery of the Rabbit Lake ore body, which contains 50 million pounds of uranium oxide, evolved from an airborne survey conducted over the area by Pan Ocean personnel in 1967.

At year-end, the Rabbit Lake mill was producing at two-thirds of capacity, and production at full capacity of 4.5 million pounds per year is expected by mid-1976. Pan Ocean's net profits interest should begin generating significant income to the Company in 1978.

An aggressive exploration program by Gulf Minerals during the past few years has resulted in the discovery and delineation of two additional uranium deposits, known as



Strachan gas plant, Alberta.

Raven and Horseshoe, located within three miles of the Rabbit Lake operation. A continued active exploratory drilling program on the 240,328 acres of surrounding claim blocks is planned for the current year. Under the net profits arrangement with Gulf Minerals, Pan Ocean does not share in any of the exploration, development or operating costs associated with this area of common interest.

Pan Ocean holds an 87.5% interest in 17,720 acres of land covering a radiometric/magnetic anomaly near the recently announced uranium discovery at Key Lake in northern Saskatchewan.

During 1975, Pan Ocean entered into a joint venture agreement with Cominco Ltd. regarding Pan Ocean's uranium prospect near Baker Lake in the **Northwest Territories.** Pan Ocean holds a 60.2% interest in 834 claims and 11 prospecting permits covering 1.5 million acres. Over the past several years, Pan Ocean has conducted both airborne and ground geophysical surveys, as well as limited diamond drilling. This work identified a number of uranium occurrences and some of those investigated by drilling tested significant values. Under the terms of the agreement announced last May, Cominco has an option to acquire a 55% participating interest in the prospect in return for expenditures totalling $5 million. Of this amount approximately $750,000 was spent during 1975, and a like amount is planned for 1976. Cominco's interest will be earned in stages after the expenditure by them of $2 million. Pan Ocean's residual interest after Cominco earns its full interest will be 27%. In the event that a feasibility study has not been completed after the expenditure of $5 million, Cominco has agreed to advance certain funds on a reducing percentage formula on behalf of the partners until completion of the study or a total expenditure of $12.5 million.

The 1975 program at Baker Lake included extensive geological, geophysical and geochemical surveys, as well as limited drilling in two areas, which confirmed uranium mineralization. Vertical Hole No. K-10 intersected an average of 2.3 pounds of uranium per ton over a 372 foot interval.

Uranium mine and mill at Rabbit Lake, Saskatchewan.

Drums of yellowcake (uranium oxide) awaiting shipment from the Rabbit Lake uranium mill.

During 1975 Pan Ocean also conducted a preliminary survey on another large area in the Northwest Territories. As a result, the Company staked 161 claims in three separate areas, and several permit applications have been filed. An airborne program is planned by Pan Ocean on this new area in 1976.

Pan Ocean holds a 75% working interest in two exclusive Research Permits in **Niger,** in west central Africa, where the Company is conducting a uranium exploration program. The two permits cover 13 million acres and negotiations are in progress for an exclusive Research Permit covering a third large area. The Company has carried out an intensive radiometric airborne survey in the country.

Pan Ocean has reactivated its exploration program in **Australia** following a recent change of government there and the enactment of new government policies significantly more favorable to foreign involvement in uranium operations. A drilling program is planned for 1976 on Company prospects in Western Australia and in the Frome Basin of South Australia. Pan Ocean has an option to acquire an 80% working interest in these properties.

Pan Ocean's uranium operations in the **United States** are conducted by Frontier Resources, Inc., an 83%-owned subsidiary. Frontier Resources holds a royalty interest in 45,000 acres in Utah presently being explored by Phillips Petroleum, and has working interests in additional exploratory properties in Montana and New Mexico.

During 1975, Pan Ocean concluded an important agreement with Toyo Menka Kaisha, Ltd., a Japanese trading company, regarding the funding of uranium exploration by Pan Ocean. Under the agreement, Toyo Menka is committed to provide $1 million, and has the option to provide a further $1 million, for use by Pan Ocean in uranium exploration programs. Toyo Menka may recover the funds advanced only through the purchase of a specified amount of uranium, assuming the exploration is successful, in which case Toyo Menka will also be responsible for providing a certain amount of funds for mine and mill development.

Coal

In May 1975, Rio Tinto Canadian Exploration Limited submitted a feasibility report on the Company's Sage Creek coking coal project in the Flathead Valley of **British Columbia.** The report culminated four years of work by Rio Tinto costing approximately $3 million and earned Rio Tinto a 60% interest in the project. An extensive field program during 1975 provided further detailed information on transportation requirements, mine design and coal preparation facilities. Work to date, including 140 drill holes and 14 adits, has defined in situ reserves exceeding 140 million tons of low sulphur medium volatile coal, confirmed by potential users as typical of other western Canadian coking coals. Close liaison has been established with environmental authorities and their requirements form the basis for all design parameters.

A group of independent consultants, headed by Kaiser Engineers of Oakland, California, was engaged in mid-1975 to compile a final feasibility report which should be completed in mid-1976. The project is expected to be released for construction in early 1977 and initial production from the mine is contemplated in 1980. The mine will have a capacity of three million tons of coking coal per year. Long term requirements and price projections for the type of coking coal to be produced at Sage Creek remain favorable and it is anticipated that a major portion of production will be destined for Japan, where initial negotiations are now in progress.

Exploration carried out by Pine Pass Development Co. on the Company's 43,842 acres of coal lands in northeastern British Columbia defined an area of potentially economic coal reserves and the area will undergo further exploration in 1976. These expenditures are borne exclusively by Pine Pass Development Co. under the terms of their option to earn a 60% interest in the project.

During 1975, Pan Ocean sold its Ram River coal holdings to Petrofina Canada Ltd. for cash, and retained a 2% overriding royalty convertible at Pan Ocean's option to a 10% working interest after $1 million has been expended on the property.

Other Minerals

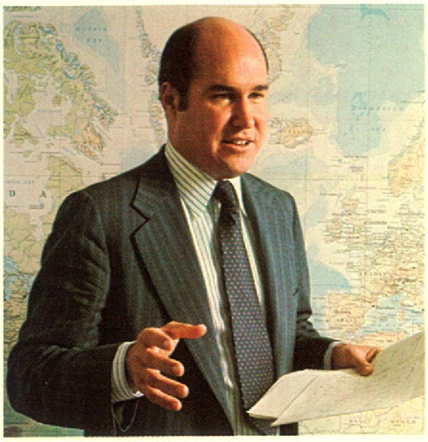
Full production at the fluorspar-zinc mine at Salem, **Kentucky,** has not yet been achieved because of underground development difficulties. The full effects of changes in mine management and alterations to mining plans are now being felt, however, and it is expected that the mine will generate operating profits by the second quarter of 1976. Frontier Resources, Inc. holds a 25% working interest in this property and Cerro Corporation is the operator. When in full production, the mine will be the largest independent producer of fluorspar in the United States. Production from the mine is being sold to the nearby Pennwalt hydrofluoric acid plant. The demand for fluorspar remains firm and prices are increasing.

Exploration on the nearby Robinson ore body continued during 1975 and a feasibility study is now in progress. Exploration is continuing on the 20,000 acres of prospective fluorspar properties held in Kentucky and Illinois.

Pan Ocean and E. H. Exploration Inc. were granted exploration contracts in the **Dominican Republic** during 1975 covering approximately 145,000 acres surrounding the large gold/silver mine owned by Rosario Dominicana S. A. and near the Falconbridge ferronickel properties. An extensive airborne program was completed in early 1976, and follow-up field programs are planned.

(Above) J. Scott Drever of Pan Ocean, foreground, and Owen Cullingham of Rio Tinto Canadian Exploration Ltd. reviewing geological interpretations of Sage Creek coal property.

(Left) Diamond drilling operations on Sage Creek coal property in British Columbia.



George P. Giard, Jr.
President of the Company.

Management

The Company announced on October 21, 1975, the appointment of George P. Giard, Jr. as President of the Company and Alaster G. Swanson as Vice Chairman of the Board. Mr. Giard, as President, operates out of the New York office and devotes particular emphasis to financial and corporate planning. Mr. Swanson, who had recently also been named Chairman of Pan Ocean Oil Ltd., operates out of the Calgary office and heads the Company's world wide mineral operations. The Company's international oil and gas operations continue to be headed by F. William Popp, Executive Vice President, headquartered in London, England. These executive nominations reflect an important broadening in the Company's senior management.

Adam A. W. Kryczka, who had served as Chairman of Pan Ocean Oil Ltd., submitted his resignation as a director and officer last year. Mr. Kryczka made substantial contributions to the early growth of Pan Ocean, and we wish him well in his new pursuits.

James F. Cowie was appointed President of Pan Ocean Oil Ltd. on July 15, 1975.

Financial

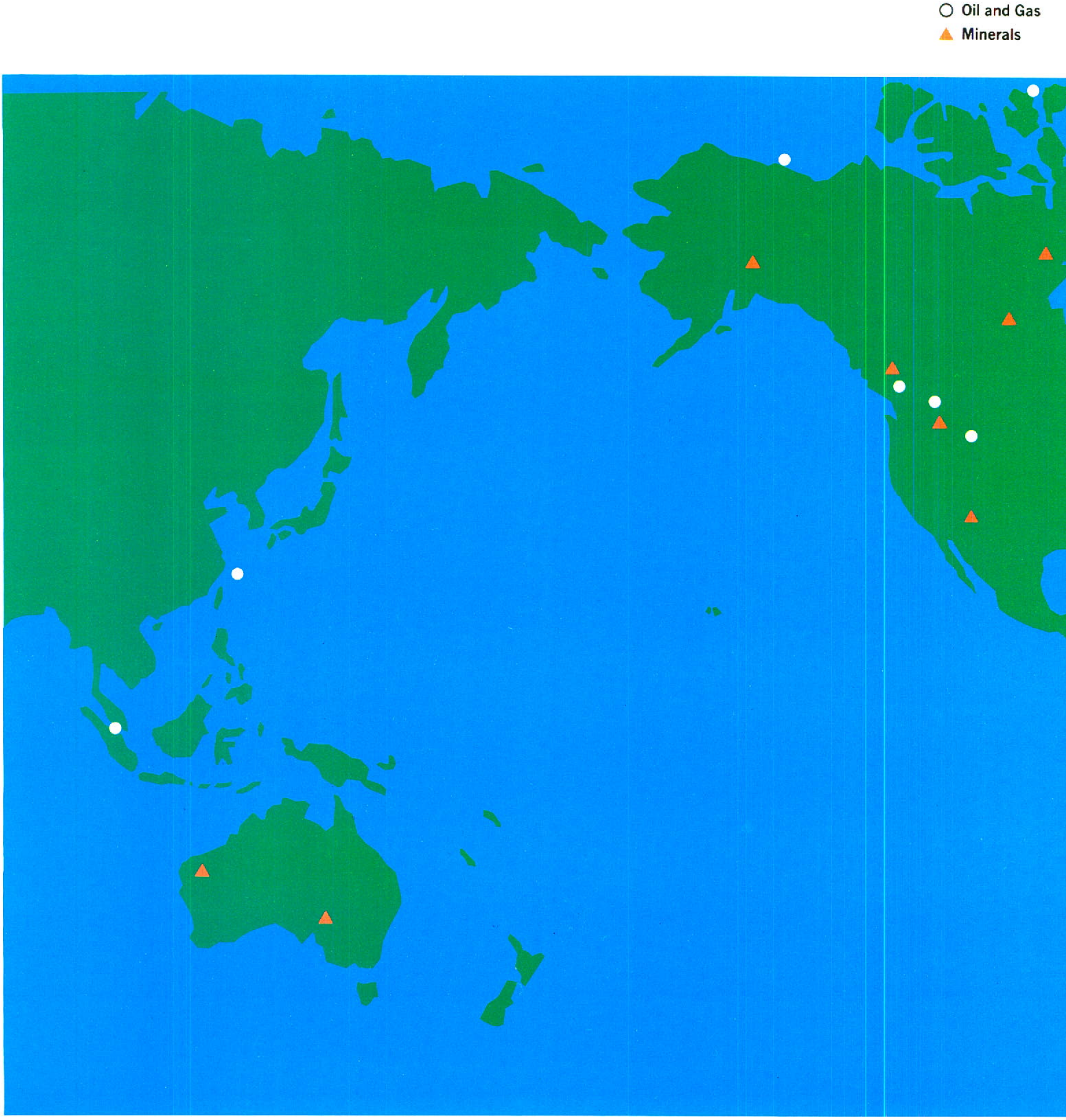
Operating revenues increased from $9,525,833 in 1974 to $11,387,115 in 1975. Much of the increase was due to higher prices realized on natural gas sales in Canada. On November 1, 1975 gross value received for Strachan gas, our largest source of income last year, increased from $.42 per thousand cubic feet to $.96 per thousand cubic feet. Taking into account this price increase and the impact of higher provincial royalties, revenues from the Strachan gas plant are expected to be up by over 36% in 1976.

Net income increased only slightly in 1975 to $680,078, or $.06 per share, from $598,508, or $.05 per share, in 1974 before an extraordinary item. An extraordinary item in 1974 increased net income to $753,508, or $.06 per share. Interest charges were up significantly in 1975. The Company increased its bank loans during 1975 by a net $25 million and also placed $15 million of 7.5% convertible subordinated notes due 1985. The Company had major expenditures last year in both the development of its Ogharefe Oil Field in Nigeria and in its North Sea drilling activity. Expenditures during 1976 are budgeted to be approximately 40% less than during 1975.

Net income, adjusted for various non-cash charges and credits, was $2,731,486 in 1975 compared to $3,553,116 in 1974.

Pan Ocean's Oil, Gas and Mineral Interests

As of December 31, 1975



Oil and Gas

	GROSS ACRES	NET ACRES
Abu Dhabi	389,183	122,592
Canada	10,942,873	1,259,735
East China Sea†	10,000,000	7,000,000
Indonesia (Malacca Straits)	7,861,734	2,759,468
Maldive Islands (Indian Ocean)	22,100,586	1,343,254
Nigeria	248,320	248,320
North Sea (Dutch Sector)	80,042	13,899
North Sea (Norwegian Sector)	129,480	25,086
North Sea (United Kingdom Sector)	217,820	60,873
United States	451,142	181,428
Total*	**52,421,180**	**13,014,655**

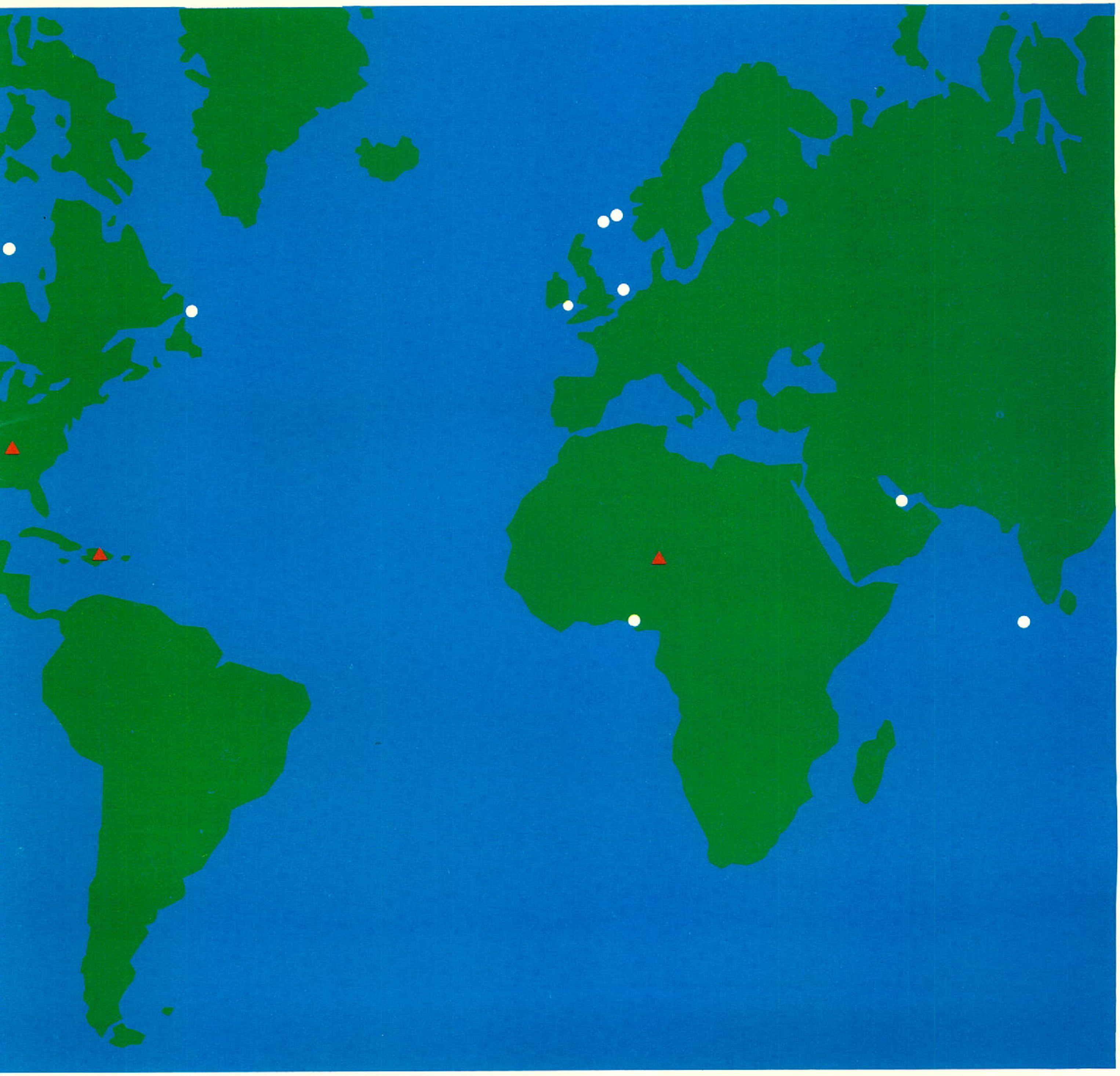
†Lease application—priority filing

*Includes only acreage in which Pan Ocean has a working interest. Does not include acreage held by Magnorth Petroleum Ltd. in the Arctic.

Minerals

	GROSS ACRES	NET ACRES
Uranium		
Canada	1,766,977	1,162,373
Niger	12,999,680	9,749,760
Australia	186,333	150,066
United States*	77,548	67,263
Coal		
Canada	109,514	86,622
Other Minerals		
Canada	16,450	14,101
Dominican Republic	144,809	92,677
United States*	65,593	28,680
Total	**15,366,904**	**11,351,542**

*United States minerals acreage is held largely by Frontier Resources, Inc., an 83%-owned subsidiary of Pan Ocean.



Consolidated Balance Sheets

ASSETS	December 31, 1975	December 31, 1974
Current assets:		
Cash	$ 1,137,558	$ 2,375,434
Time deposits	13,560,959	13,112,097
Accounts receivable	2,992,905	2,124,120
Prepaid expenses and other assets	661,521	92,065
Foreign income taxes receivable	638,000	—
Total current assets	18,990,943	17,703,716
Properties and equipment, at cost (Notes 1, 3 and 10):		
Developed oil and gas properties	18,734,291	17,982,068
Undeveloped leaseholds, mineral rights and mining claims	110,521,158	66,595,734
	129,255,449	84,577,802
Less—Accumulated depletion, depreciation and amortization	13,351,882	11,171,331
	115,903,567	73,406,471
Other assets:		
Furniture and fixtures, net of accumulated depreciation 1975—$536,463; 1974—$394,448	719,212	692,253
Investments (Note 4)	223,750	710,000
Other (Note 10)	1,568,517	495,543
	2,511,479	1,897,796
Total assets	$137,405,989	$93,007,983

LIABILITIES AND SHAREHOLDERS' EQUITY

	December 31, 1975	December 31, 1974
Current liabilities:		
Notes payable	$ 177,184	$ 850,000
Accounts payable	4,995,011	2,038,693
Accrued liabilities	1,812,987	2,978,788
Foreign income tax payable	45,846	167,000
Advance from joint interest participant	1,163,922	970,534
Long-term debt due within one year (Note 6)	5,577,131	4,038,000
Total current liabilities	13,772,081	11,043,015
Long-term debt (Note 6)	65,443,948	25,067,530
Deferred income taxes (Notes 2 and 5)	4,909,493	3,847,199
Minority interest in consolidated subsidiary	333,627	302,927
Shareholders' equity:		
Common Stock $.01 par value—authorized 30,000,000 shares; issued and outstanding 12,203,219 in 1975 and 12,202,612 in 1974 (Note 7)	122,032	122,026
Preferred stock $1.00 par value—authorized 5,000,000 shares; issued—none	—	—
Capital in excess of par value	71,012,137	71,006,443
Deficit (Notes 2 and 4)	(18,187,329)	(18,381,157)
Total shareholders' equity	52,946,840	52,747,312
Commitments and contingencies (Note 10)	—	—
Total liabilities and shareholders' equity	$137,405,989	$93,007,983

The accompanying notes are an integral part of these statements.

Consolidated Statements of Income

	For the year ended December 31, 1975	1974
Revenues:		
Sales and other operating revenue	$11,387,115	$9,525,833
Interest and dividend income	303,648	334,917
Loss on disposition of interest in oil and gas properties	(91,039)	(43,835)
Other income	10,300	100,000
	11,610,024	9,916,915
Costs and expenses:		
Production and lease operating expenses	1,366,367	1,259,597
Depletion, depreciation and amortization	1,897,622	1,903,784
Interest expense	4,158,760	1,438,930
Less interest capitalized (Note 9)	(909,208)	—
General and administrative expenses	4,112,565	3,398,272
	10,626,106	8,000,583
Income before income taxes and minority interest	983,918	1,916,332
Provision for foreign income taxes (Note 5):		
Current	(759,154)	322,000
Deferred	1,062,294	949,099
	303,140	1,271,099
	680,778	645,233
Minority interest in consolidated subsidiary	700	46,725
Income before extraordinary item	680,078	598,508
Extraordinary item:		
Reduction in income taxes payable arising from realization of prior years' tax losses	—	155,000
Net income	$ 680,078	$ 753,508
Per average share of common stock and common stock equivalents (Note 8):		
Income before extraordinary item	$.06	$.05
Extraordinary item	—	.01
Net income	$.06	$.06

The accompanying notes are an integral part of these statements.

Consolidated Statements of Changes in Financial Position

	For the year ended December 31, 1975	1974
Financial resources were provided by:		
Income before extraordinary item	$ 680,078	$ 598,508
Add—Charges (credits) not requiring working capital:		
Depletion, depreciation and amortization	1,897,622	1,903,784
Provision for deferred income taxes	1,062,294	949,099
Charge in lieu of income taxes	—	155,000
Minority interest	700	46,725
Interest Capitalized	(909,208)	—
Other income	—	(100,000)
Working capital provided by operations	2,731,486	3,553,116
Proceeds on sales of developed properties	1,183,861	1,246,148
Proceeds on sales and dispositions of interests in undeveloped properties	294,409	233,286
Proceeds from sales of common stock	5,700	104,746
Net increase in long-term debt	40,376,418	21,330,751
Total source of funds	44,591,874	26,468,047
Financial resources were used for:		
Additions to properties and equipment:		
Developed oil and gas properties	1,408,424	970,332
Undeveloped oil, gas and mineral properties	44,021,870	24,129,663
Furniture and fixtures	188,861	437,318
	45,619,155	25,537,313
Other items, net	414,558	63,664
Total application of funds	46,033,713	25,600,977
Increase (decrease) in working capital	(1,441,839)	867,070
Working capital at beginning of year	6,660,701	5,793,631
Working capital at end of year	$ 5,218,862	$ 6,660,701
Changes in components of working capital:		
Increase (decrease):		
Current assets—		
Cash	($1,237,876)	$ 1,138,275
Time deposits	448,862	10,268,865
Marketable securities	—	(312,623)
Receivable from sale of oil and gas properties	—	(4,156,510)
Accounts receivable	868,785	560,663
Prepaid expenses and other assets	569,456	(32,924)
Foreign income taxes receivable	638,000	(115,217)
	1,287,227	7,350,529
Current liabilities—		
Notes payable	(672,816)	850,000
Accounts payable	2,956,318	957,578
Accrued liabilities	(1,165,801)	2,684,321
Foreign income tax payable	(121,154)	167,000
Advance from joint interest participant	193,388	246,560
Long-term debt due within one year	1,539,131	1,578,000
	2,729,066	6,483,459
Increase (decrease) in working capital	($1,441,839)	$ 867,070

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 31,1973	$ 121,903	$70,901,820
Proceeds from sales of 12,355 shares of common stock upon exercise of stock options during 1974	123	104,623
Balance at December 31, 1974	122,026	71,006,443
Proceeds from sales of 607 shares of common stock upon exercise of stock options during 1975	6	5,694
Balance at December 31, 1975	$ 122,032	$71,012,137

Statements of Deficit

	For the year ended December 31, 1975	1974
Deficit, beginning of year	($18,381,157)	($16,376,565)
Cumulative effect of 1974 accounting change (Note 2)	—	(2,758,100)
Deficit, beginning of year, as restated	(18,381,157)	(19,134,665)
Net Income	680,078	753,508
Investment valuation allowance (Note 4)	(486,250)	—
Deficit, end of year	($18,187,329)	($18,381,157)

The accompanying notes are an integral part of these statements.

Notes to Consolidated Financial Statements

Note 1—Accounting Policies:

Consolidation:

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

Oil and Gas Properties:

Canada and Other Foreign Areas

The Company follows the full-cost method of accounting for costs of its oil and gas properties outside 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. Costs are accumulated in separate cost centers for Canada 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. Costs incurred in Other Foreign Areas are being deferred pending the results of exploration and development programs. These costs will be amortized as discovered reserves for the Other Foreign Areas cost center are produced. No gain or loss is recognized on the disposal of properties.

The Company has developed reserves in Canada and undeveloped reserves in Other Foreign Areas. Net capitalized costs associated with developed and undeveloped properties included in the Canadian and Other Foreign Areas cost centers will be limited to the value of recoverable oil and gas reserves applicable to each cost center.

United States

Costs of developed properties in the United States are being amortized 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 results of operations. Net capitalized costs for developed properties will be limited to the value of recoverable reserves in the United States.

Mineral Properties:

The Company follows the full-cost method for all 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. Net capitalized costs of mineral properties will be limited to the value of recoverable mineral reserves.

Foreign Exchange:

Current assets and current and noncurrent liabilities of foreign subsidiaries are translated to U.S. dollars at rates of exchange in effect at the balance sheet dates, noncurrent assets at rates of exchange in effect when the assets were acquired. Income accounts are translated at average exchange rates in effect during the periods presented, except for depletion, depreciation and amortization charges which are based on historical dollar equivalents of the related assets.

Note 2—Change in Method of Accounting for Deferred Income Taxes:

Prior to 1974 the Company, in common with many other companies in the oil and gas industry in Canada, did not provide for deferred taxes applicable to differences between financial statement income and taxable income (timing differences). Effective January 1, 1974, the Canadian provincial securities commissions required oil and gas companies in Canada to provide for deferred income taxes with respect to timing differences applicable to Canadian drilling, exploration and lease acquisition costs. Accordingly, the Company adopted comprehensive tax allocation retroactively with respect to Canadian drilling, exploration and lease acquisition costs. The effect of this accounting change was to reduce net income in 1974 by $949,099 or $.08 per share and increase the accumulated deficit at January 1, 1974 by $2,029,000 representing the estimated effect of the retroactive computation. In 1975 the Company adjusted the original retroactive computation to provide additional deferred taxes of $729,100. This provision related entirely to results of operations prior to 1974 of certain acquired subsidiaries.

Note 3—Properties and Equipment:

	December 31, 1975	December 31, 1974
Developed oil and gas properties and related equipment:		
Canada:		
Producing lands and leases	$ 8,799,135	$ 8,331,110
Processing plant and related equipment	6,693,297	5,929,733
Lease and well equipment	901,095	759,683
	16,393,527	15,020,526
United States:		
Producing lands and leases	1,540,251	1,990,078
Lease and well equipment	800,513	971,464
	2,340,764	2,961,542
	$ 18,734,291	$17,982,068
Undeveloped properties:		
Oil and gas:		
Canada	$ 12,313,978	$10,708,905
United States	2,152,900	1,736,117
Other Foreign Areas	85,961,562	46,555,882
	100,428,440	59,000,904
Mineral Properties	10,092,718	7,594,830
	$110,521,158	$66,595,734
Total developed and undeveloped properties	$129,255,449	$84,577,802
Less: Accumulated depletion, depreciation and amortization	13,351,882	11,171,331
	$115,903,567	$73,406,471

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 and the value of producing proven reserves in the United States 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 in excess of 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 4—Investments:

Investments at December 31, 1975 consist of marketable securities with an original cost basis of $710,000. Total quoted market value of such securities at December 31, 1975 was $223,750. Although management believes there has been no permanent impairment in the original cost basis, a valuation allowance of $486,250, representing the gross unrealized loss, has been established by a charge to shareholders' equity.

At December 31, 1974 marketable securities were not required to be carried at the lower of cost or market and were carried at cost. Market value of such securities approximated $370,000 at December 31, 1974.

Note 5—Income Taxes:

For 1975 and 1974, the Company and its United States subsidiaries have had losses before taxes. While the Company's Canadian subsidiaries had income in these 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. The 1974 current provision for Canadian income taxes of $322,000 was reduced by $155,000 representing utilization of prior years' tax losses.

On November 18, 1974 the Canadian Government proposed amendments to the Income Tax Act that substantially increased the income taxes of the resource industries. Responding to this action some provinces proposed incentive grants in order to provide a measure of relief to resource companies. Although the Federal and Provincial proposals have now been enacted there are many uncertainties with respect to their interpretation and application. The Company has used its best efforts to make reasonable provisions for income taxes under the circumstances. The difference between taxes computed by applying the Canadian corporate tax rate of 51% and actual tax expense is accounted for as follows:

	1975	1974
Computed tax expense	$1,548,000	$1,686,000
Add (deduct):		
Crown charges disallowed for tax purposes	1,477,000	664,000
Resource profits rate reductions	(473,000)	(334,000)
Earned depletion	(1,197,000)	(761,000)
Provincial resource industry rebates	(1,098,000)	(485,000)
Other	(25,900)	317,000
Canadian tax expense	$231,100	$1,087,000

Additional amounts of $72,040 and $29,099 were provided for other foreign income taxes in 1975 and 1974, respectively.

At December 31, 1975 the Company had net operating loss carry-overs of approximately $54,350,000 available to reduce future United States taxable income. Approximately $8,800,000 of such loss carry-overs expire in 1977, $12,675,000 in 1978, $12,875,000 in 1979 and $20,000,000 in 1980.

At December 31, 1975 the Canadian subsidiaries had approximately $600,000 of qualifying expenditures remaining on which to claim a deduction for earned depletion and capital cost allowances of $6,344,000 available to be carried forward and applied against future Canadian taxable income.

Note 6—Long-term Debt:

	December 31, 1975	December 31, 1974
Secured bank loan, at ¾% over bank's U.S. base rate (a)	$18,800,000	$19,000,000
Secured bank loan, at ¾% over Canadian prime rate (a)	6,042,992	10,105,530
Secured bank loan, at 1% over Canadian prime rate (a)	4,592,927	—
Secured bank loan, at 1½% over Canadian prime rate (b)	14,763,000	—
Note payable (c)	1,000,000	—
Secured revolving credit note (d)	10,000,000	—
7½% convertible subordinated notes (e)	15,000,000	—
Other	822,160	—
	71,021,079	29,105,530
Less—Current portion	5,577,131	4,038,000
	$65,443,948	$25,067,530

(a) Secured by assignments of interests in certain Canadian hydrocarbon reserves. Principal and interest payable monthly.

(b) Secured by assignments of interests in the Company's uranium net profits interest and certain Canadian hydrocarbon reserves. Principal payments quarterly commencing February, 1978; interest payable quarterly.

(c) Interest payable quarterly at the London interbank rate; principal due January, 1979.

(d) Secured by stock of wholly-owned subsidiary; interest payable quarterly at the minimum commercial lending rate plus 1%; principal due April 1, 1977; requires 10% compensating balance.

(e) Principal due November 30, 1985; interest payable semiannually commencing June 1, 1976. The notes are convertible into Pan Ocean Oil Corporation common stock at the principal amount for $8.00 per share. At December 31, 1975 1,875,000 shares are reserved for such conversion.

The various agreements impose certain restrictions on the Company including restrictions on the payment of cash dividends. Under the most restrictive agreement the Company cannot pay dividends prior to December 31, 1979. Thereafter dividends are limited to 75% of consolidated net income accrued or earned subsequent to December 31, 1978.

The Company's average interest rate on outstanding bank borrowings during 1975 was approximately 9.6%. Required repayments approximate $15,966,000 in 1977, $9,552,000 in 1978, $11,241,000 in 1979, $11,337,000 in 1980 and $1,526,000 in 1981.

Included in other assets is approximately $225,000 of deferred debt issuance costs incurred in connection with the issuance of the 7½% convertible subordinated notes. These costs are being amortized over the 10-year life of the notes.

Note 7—Stock Options:

The Company has a Non-Qualified Stock Option Plan, (1974 Plan) to grant options to employees to purchase up to 500,000 shares. Options granted under the 1974 Plan expire ten years from the date of grant and may be exercised in cumulative annual installments of 25% of the total shares subject to option in the second through fifth years and are fully exercisable for the remainder of the term except for amended options on 65,000 shares which are exercisable 25% in the second year and fully exercisable in the third year. The purchase price payable upon exercise of options is 100% of the fair market value of the Common Stock on date of grant, reduced by the amount, if any, that the fair market value of the Common Stock on the date of exercise exceeds the fair market value on the date of grant.

The Company also has outstanding employee stock options to purchase an aggregate of 6,068 shares under a prior plan and options to purchase an aggregate of 65,000 shares held by five persons who are not employees of the Company.

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, 1974	372,077	\$5⅞–\$15⅞
December 31, 1975	424,218	\$5⅞–\$15⅞
Options which became exercisable in:		
1974	53,471	\$9½–\$15⅞
1975	56,344	\$5⅞–\$15⅞
Options exercised in:		
1974	12,355	\$8–\$12
1975	607	\$9.39

Of the 424,218 shares, options for 266,693 shares were exercisable at December 31, 1975.

Note 8—Earnings per Share:

Per share amounts are based on the weighted average number of common shares outstanding during each year adjusted for the assumed exercise of all dilutive stock options computed by the applicaiton of the "treasury stock" method. The number of shares used in the per share computations for 1975 and 1974 are 12,239,485 and 12,238,068, respectively.

Fully diluted per share amounts have not been presented since the assumed conversion of the convertible subordinated notes would have an antidilutive effect.

Note 9—Capitalization of Interest:

Interest cost relating to funds borrowed for major oil and gas field or mine development projects is capitalized during the development period in order to provide a more realistic matching of expenses with revenues expected to be generated as a result of such development projects.

The amount of interest capitalized in a period is determined by applying the effective interest rates under the applicable borrowing agreements to the amount of funds borrowed for or allocated to development projects. This capitalized interest is amortized over the life of the asset after it is placed in service.

If all interest costs had been expensed as incurred, net income in the year ended December 31, 1975 would have been reduced by \$902,641 and net income would have been increased by \$7,597 in the year ended December 31, 1974.

Note 10—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, 1975 these obligations amounted to approximately \$3,300,000 for 1976, \$2,200,000 for 1977 and \$1,600,000 for 1978. In connection with the Company's development programs, substantial additional expenditures will be made.

Minimum annual rental commitments under non-cancellable leases net of sublet rentals of \$323,000 through 1979 are \$397,000; 1980—\$354,000. From 1981 to 1985 aggregate rental commitments are \$562,000 and commitments subsequent to 1985 total approximately \$216,000.

Total rental expense charged to income was \$480,000 in 1975 and \$420,000 in 1974.

Contingencies:

In 1971 the Canadian Department of National Revenue issued notices of reassessment disallowing certain deductions claimed in arriving at taxable income for prior 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, 1975 and 1974.

The Company has no knowledge of any litigation or tax or other claims pending or considered likely or any other contingent liabilities of any important consequence.

Report of Independent Accountants

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

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, deficit, common stock, capital in excess of par value and changes in financial position present fairly the financial position of Pan Ocean Oil Corporation and its subsidiaries at December 31, 1975 and 1974, and the results of their operations and the changes in their 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.

Price Waterhouse & Co.

New York, New York
March 4, 1976

Five-Year Financial Summary

(Dollars in thousands, except per share amounts)

	1975	1974	1973	1972	1971
RESULTS OF OPERATIONS					
Sales and other operating revenues	$11,387	$9,526	$7,112	$7,059	$5,915
Other revenues, net	$ 223	$ 391	$1,012	$1,006	$ 854
Production and lease operating expenses	$ 1,366	$1,260	$1,302	$1,318	$1,572
Depletion, depreciation and amortization	$ 1,897	$1,904	$1,714	$1,562	$1,568
Interest expense	$ 4,159	$1,439	$1,309	$1,330	$1,656
Less interest capitalized	($ 909)	—	—	—	—
General and administrative expenses	$ 4,113	$3,398	$2,872	$2,690	$3,446
Income (loss) before income taxes	$ 983	$1,870	$ 905	$1,165	($1,473)
Income taxes	303	1,271	828	665	492
Income (loss) before extraordinary items	680	599	77	500	(1,965)
Extraordinary items	—	155	943	280	(6,153)
Net income (loss)	$ 680	$ 754	$1,020	$ 780	($8,118)
PER SHARE OF COMMON STOCK					
Income (loss) before extraordinary items	$.06	$.05	$.01	$.05	($.20)
Extraordinary items	—	.01	.08	.02	(.62)
Net income (loss)	$.06	$.06	$.09	$.07	($.82)
FINANCIAL POSITION					
Current assets	$ 18,991	$17,704	$10,353	$16,886	$15,770
Current liabilities	$ 13,772	$11,043	$ 4,560	$ 3,371	$ 8,410
Working capital	$ 5,219	$ 6,661	$ 5,793	$13,515	$ 7,360
Properties and equipment, net	$115,904	$73,406	$51,510	$42,460	$33,201
Long-term debt	$ 65,444	$25,068	$ 3,737	$15,838	$15,926
Shareholders' equity (1)	$ 52,947	$52,747	$51,889	$39,390	$24,609
AVERAGE SHARES OF COMMON STOCK OUTSTANDING (in thousands)	12,239	12,238	11,434	10,615	9,847

(1) Figures prior to 1975 have been adjusted to provide for deferred Canadian income taxes.

Management Discussion and Analysis of the Results of Operations

1975 Compared to 1974

Sales and other operating revenues increased in 1975 to $11,387,000 from $9,526,000 in 1974 as a result of higher selling prices in Canada. Canadian operating revenue increased approximately $2,000,000.

Interest expense increased by $2,720,000 in 1975 over the preceding year as a result of a net increase of approximately $40,000,000 in long-term debt. A portion of this interest expense aggregating approximately $909,000, relating to funds borrowed for major hydrocarbon and mineral development projects is capitalized during the development period of such projects in order to provide a more meaningful matching of expenses with revenues.

Continued expansion of the London office contributed $300,000 to the overall increase of approximately $700,000 in general and administrative expense in 1975. The remaining portion of this increase reflects substantial increases in professional fees, higher salaries paid to executives and the impact of inflation.

In 1974 the Company provided $322,000 for its current Canadian tax liability which was offset by an extraordinary credit of $155,000 resulting in a current liability of $167,000. In addition a provision for deferred taxes of $949,000 was made against income in 1974.

In 1975 the Company recorded a credit of $759,000 representing a current tax refund. In addition a provision for deferred taxes of $1,062,000 was recorded resulting in a net foreign income tax provision of $303,000. In general the Company's total 1975 provision for income tax is lower than the 1974 provision as a result of higher earned depletion for tax purposes attributable to the attainment of higher production profits in Canada and higher Provincial resource industry rebates related to newly enacted Canadian tax legislation.

1974 Compared to 1973

The increase in sales and other operating revenues to $9,526,000 in 1974, as compared with $7,112,000 in 1973, resulted primarily from higher selling prices in both Canada and the United States. Canadian operating revenue increased approximately $2,000,000 of which $1,500,000 was associated with the Strachan natural gas unit in Alberta. The additional $400,000 was associated mainly with certain producing properties, located in the southern part of the United States presently owned by Frontier Resources, Inc.

The Company had a larger amount of cash available for investment in 1973 than in 1974, resulting in a decrease in 1974 in other revenues of approximately $425,000 out of a total decrease of approximately $620,000 in other revenues. A decrease in other income of $150,000 made up substantially all of the remaining decrease.

Results in 1974 were adversely affected because the expansion of the London and Lagos offices caused an increase in the charge for depreciation. The depletion charge for the Canadian cost center increased because a sale of a developed property affected the rate used while the base to be amortized grew because of exploration. The overall increase in depletion, depreciation and amortization was $190,000, representing the difference between $1,714,000 in 1973 and $1,904,000 in 1974.

Interest expense increased by $130,000 in 1974 over the preceding year. However, the composition of the Company's long-term debt changed materially during this period. During 1973 approximately $750,000 of interest was attributable to a subordinated convertible note which was fully converted in late 1973. The remaining interest expense was almost entirely associated with a Canadian secured bank loan which averaged $5,400,000 during 1973. In July 1974 the Company refinanced and replaced that borrowing and increased its long-term debt by $15,000,000, resulting in total long-term debt of $20,000,000. In December 1974 the Company further increased long-term debt to $30,000,000. All but approximately $100,000 of interest expense for 1974 of $1,439,000 is associated with such long-term debt.

Continued expansion of the Company's offices in London and Lagos contributed 31% to the total 1974 increase of $526,000 over 1973 general and administrative expenses. The remaining portion of this increase reflects substantial increases in professional fees incurred and higher salaries paid by the Company's Canadian subsidiary.

The Company, in common with many other companies in the oil and gas industry in Canada, had followed the practice of not providing for deferred taxes applicable to certain timing differences. However, in 1973 the Canadian provincial securities commissions 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. In 1974, the Canadian provincial securities commissions indicated that oil and gas companies in Canada should provide for deferred income taxes. Accordingly, the Company has adopted retroactively comprehensive tax allocation. The effect of this accounting change was to reduce net income in 1974 by $949,000 or $.08 per share.

Stock Price and Dividend Information

The following table indicates the quarterly high bid and low bid prices for Pan Ocean Common Stock in the over-the-counter market during the first two quarters of 1974, and the high sale and low sale prices on the American Stock Exchange during the third and fourth quarters of 1974 and during 1975:

	U.S. Over-the-Counter Market	
	High Bid	Low Bid
1974:		
First Quarter	18⅛	13¾
Second Quarter	14	8⅞
	American Stock Exchange	
	High Sale	Low Sale
Third Quarter	13¾	6¼
Fourth Quarter	9¾	5¼
1975:		
First Quarter	13⅛	6¼
Second Quarter	13½	10¼
Third Quarter	12¼	8
Fourth Quarter	11¼	7½

The Company has not paid any dividends to date.

Stockholders may obtain a copy, without charge, of the Company's Annual Report on Form 10-K, as filed with the Securities and Exchange Commission, by writing to the Secretary, Pan Ocean Oil Corporation, 645 Madison Avenue, New York, New York 10022.

Board of Directors

Peter A. Banker
Vice President of the Company

*John M. Emery
Partner, Breed, Abbott & Morgan, attorneys New York

George P. Giard, Jr.
President of the Company

*Yasuhiro Goh
Director, Bridgestone Liquefied Petroleum Gas Company, Tokyo

Don V. Ingram
Vice President, Paine, Webber, Jackson & Curtis Inc., securities broker-dealer, Dallas

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Neil A. McConnell
Partner, McConnell & Co., securities broker-dealer, New York

F. William Popp
Executive Vice President of the Company

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

Samuel P. Reed
President, Engelhard Hanovia, Inc., investments and industrial management, New York

Alaster G. Swanson
Vice Chairman of the Board of the Company

Victor E. Trudel
Independent consultant

*Members of the Executive Committee

Officers

Stanley R. Rawn, Jr.
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George P. Giard, Jr.
President—New York

Alaster G. Swanson
Vice Chairman of the Board—Calgary

F. William Popp
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Vice President—New York

Thomas P. Sullivan
Treasurer, Controller—New York

Isabel A. Dempsey
Secretary—New York

Corporate Headquarters

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

Operations Offices

Pan Ocean Oil Ltd.
1050 No. 3 Calgary Place
Calgary, Alberta, Canada

Pan Ocean Oil (U.K.) Ltd.
14 Berkeley Street
London W1X 5AE England

Frontier Resources, Inc.
515 Majestic Building
Denver, Colorado 80202

Pan Ocean Oil Corporation (Nigeria)
2/4 Adeola Odeku Street
Lagos (Victoria Island), Nigeria

Pan Ocean Oil Ltd.
BP-1006
Sonara Building
Niamey, Niger

Pan Ocean Oil Corporation (North Sea)
c/o Sea Oil Support Base
Ferryden, Montrose
Angus, Scotland DD10 9SL

Transfer Agent and Registrar

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

The Canada Trust Company
Calgary, Alberta, Canada

General Counsel

Breed, Abbott & Morgan
New York, New York

Independent Accountants

Price Waterhouse & Co.
New York, New York

Pan Ocean Oil Corporation

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

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