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HYDROCARBON PRODUCTION COMPANY, INC.

ANNUAL REPORT

1954

New York, N.Y.
May 16, 1955.

To the Share-Owners:

Presented herewith is (1) Statement of Financial Condition of Hydrocarbon Production Company at December 31, 1954, (2) Statement of Earnings and of Earnings Retained in the Business for the year ended December 31, 1954, and (3) Working Capital Forecast for the year 1955.

The operations of the Company have continued to produce comfortably the requirements for interest payments, loan repayments, operating expenses, maintenance and work-over costs and necessary additions to plant, such as compressors. They have not generated much more, however. In the circumstances the Directors have, until now at least, deemed it prudent to postpone recommending that deep-testing of the properties which would call for assessment on share-owners. Budget appropriations for capital expenditure in 1955, therefore, will be normally low. The subject of a deep exploratory test will be reviewed at the coming meeting of the Directors, in June. Share-owners will be apprised promptly, if there is a reversal of Director attitude.

At the end of 1954 the Company was producing gas and distillate from 13 wells, one more than at the beginning of the year, the new producer being the #1 DeKock drilled jointly with Western Natural Gas, Taylor Oil and Gas, Mayfair Minerals, Inc. Hydrocarbon's interest in the new well is 20.3%. This well was completed dually in a stray sand at 6877' and in the "M" sand at 7445'. In addition, behind the pipe, ready for later completion, are some 30 feet of "A" sand.

The well was drilled to a total depth of 9516', deeper than any well recently drilled in the Lacy Field, although not as deep as Hydrocarbon's Nos. 1 and 2 Crain & Griffith, drilled by Rogers Lacy, before purchase by Hydrocarbon.

It had been hoped that sands deeper than our regular producers would be found carrying saturation. Such was not the case and the well did little more than point up the desirability of the eventual drilling of the much discussed "deep" test so that the problem of the presence or absence of deeper producing sands may be resolved.

A breakdown of sands from which production was obtained during the year follows: five producers each from the "A" and "D" sands, one producer each from the "B", "C", "E", "M", "R", and "Stray". The discrepancy between the 16 sands recorded here with but 13 producing wells stems from the dual-completion status of three wells, viz. #11 and #12 Crain & Griffith and #1 DeKock.

At year-end, difficulties with production were being experienced with Nos. 11 and 14 Crain & Griffith and it would appear that some corrective procedure will be necessary in 1955. An attempt will be made to hydrafrac the "C" sand or tubing completion of well #11 in order to improve its volume of production as well as its producing pressure. Should significant improvement be recorded as a result of this procedure it will be possible to chalk up an important increase in "C" sand reserves. This sand is known to carry gas over a wide-spread area but no large reserves have been assigned to it because of its impermeable nature. A successful "frac" treatment would open up productive possibilities for it in several wells where the sand is already safely behind pipe. This hoped for improvement would also free the compressor now being used on this well for service of the "D" sand. Concurrent with this the "B" completion in this well would be shut-in. The well produces water and a low gas volume which we feel cannot be improved.

The "R" sand in well #14 has shown an increasing tendency to make water and it can be freely predicted that water will soon take over completely.

When this occurs the well will be re-worked in an attempt to obtain a water shut off. If this is impossible completion will be effected in another sand.

Production performance of the various sands at Lacy in 1954 has been as good as or better than predicted in the past. The "D" sand pressures have declined at a steady rate as expected. Those wells producing from this sand but not yet under compression will be under compression early in 1955. This should enable us to obtain a maximum volume of gas from this reservoir. Two compressors are now in use and the purchase of another one is contemplated. Should all present plans eventuate, then the following wells soon will be connected for compression: of the "D" sand wells--Nos. 4, 6, 10 and 13 Crain & Griffith and Sykes #1, in short, every "D" sand producer, "A" sand wells--#1 Schwarz-Ritcheson and #12-C Crain & Griffith, and the one "E" sand well--#12-T Crain & Griffith. Bottom hole pressures in the remaining wells should preclude necessity for compressor installation for some time.

Production and sales of gas during 1954 amounted to 8.6 billion cubic feet, a daily average of 23.5 million cubic feet. Distillate was produced at the rate of approximately 350 barrels per day aggregating 127,200 barrels for the year. These figures will compare favorably with production in previous years and indicate that production is holding up well. 1953 sales were 8.3 billion cubic feet and 1952 sales were 9.4 billion cubic feet.

Hydrocarbon's reserve picture at Lacy Field has shown improvement during the year based primarily on better performance in the two key sands--"A" and "D"--as determined from recent reservoir pressure information.

With the installation of compressors where necessary, present rates of production are expected to continue at least into 1956. It can be anticipated, in short, that we can continue to produce and sell approximately 23,000 MCF of gas per day. In 1954 this production percentage-wise by sands was as follows: "D"--36%, "A"--42%, "others"--22%. The loss of a 36% volume when "D" is depleted will be possible to make up by (1) re-completions in sands behind pipe in present "D" producers, (2) increases in production from "A" and "other" sands, or (3) wells not yet drilled. No serious study has yet been made of this problem but it will be given attention during 1955. No real difficulties are contemplated in connection with this but a certain amount of planning and looking ahead will be necessary.

1954 sales of gas amounted to $602,488.14, and distillate sales to $346,804.13. 1953 gas sales amounted to $526,870.01, and distillate to $369,781.23.

Payments to the banks, both the regular monthly principal payments and the 75% of Net Available Funds, during the year were $531,491.84. Interest paid during this period was $86,359.02. Total payments to the banks of every kind, therefore, were $617,850.86.

Sincerely yours,

President

HYDROCARBON PRODUCTION COMPANY, INC.
Working Capital Forecast
For Year 1955

Original capital raised by Company as follows:

Item A - (1)	Preferred stock money	$ 1,200,000
(2)	Common stock money	20,000
(3)	Mortgage funds	3,100,000
	A total of	$ 4,320,000

Item A - (4)	So that Company started with cash		$4,320,000
(5)	Up to 12/31/54 it collected income from all sources amounting to		3,628,977
(6)	Making total working capital available to Company to 12/31/54		7,948,977
(7)	Up to that date it expended working capital		
(a)	For leaseholds and equipment	$3,600,000	
(b)	Operating expenses, interest and taxes	1,330,544	
(c)	Capital expenditures	1,136,099	
(d)	Repayments	1,640,356	
	A total of		7,706,999
	Leaving working capital at 12/31/54		241,978
Item B -	Add expected 1955 income from sales		920,000
Item C -	Which will make available for expenditures in 1955 a total of		1,161,978
Item D -	The first call on which will be as follows:		
(1)	Interest on notes	$ 65,000	
(2)	Principal payment on notes	360,000	
(3)	75% available funds	190,000	
(4)	Federal Income Taxes - estimated	40,000	
	Total first call expenditures		655,000
Item E -	Leaving for operating expenses, working capital cushions and capital expenditures in 1955		$ 506,978

HYDROCARBON PRODUCTION COMPANY, INC.

Financial Report

For The Year Ended December 31, 1954

HYDROCARBON PRODUCTION COMPANY, INC.

Statement of Financial Condition

December 31, 1954

ASSETS

Current Assets:		
Cash	$ 139,822.30	
Accounts receivable - trade (Note A)	140,201.61	
Inventory - supplies - at cost	47,431.76	$ 327,455.67
Property, Leaseholds and Equipment - at cost	4,340,756.82	
Less reserves for depreciation and depletion	1,652,527.13	2,688,229.69
Special Deposits		963.57
Deferred Charges		3,808.84
		$3,020,457.77

LIABILITIES

Current Liabilities:		
5% notes payable - due within one year (Note B)	$ 358,593.66	
Accounts payable and accrued accounts	46,410.42	
Accounts payable - affiliated companies	12,339.50	
United States taxes on income	31,181.06	$ 448,524.64
5% Notes Payable (Note B)		1,101,051.08
Reserve for Taxes		318.94
Share-owners' Investment:		
Capital Stock:		
Preferred - $5 non-cumulative to January 1, 1956; cumulative thereafter; par value $100 per share:		
Authorized, issued and outstanding - 12,000 shares	1,200,000.00	
Common - par value $1 per share:		
Authorized, issued and outstanding - 20,000 shares	20,000.00	
Earnings retained in the business (Note C)	250,563.11	1,470,563.11
		$3,020,457.77

Notes:

A Includes $67,391.52 due from a customer who is operating under a creditors' extension agreement. No provision has been made for loss thereon.

B The notes are payable in variable monthly instalments; balance is due July 1, 1960. Current assets and property, leaseholds and equipment are pledged under a Deed of Trust as security for the notes.

C Under the terms of the Deed of Trust the company may not pay dividends (except in capital stock of the company) or make any distribution or return of capital except with consent of the note holders.

HYDROCARBON PRODUCTION COMPANY, INC.

Statement of Earnings and of Earnings Retained in the Business

For the Year Ended December 31, 1954

Sales:		
Gas	$602,488.14	
Oil - distillate	346,804.13	$949,292.27
Operating Expenses (exclusive of depreciation and depletion)	198,647.59	
General and Administrative Expenses	27,714.44	226,362.03
Operating Profit (before provision for depreciation and depletion)		722,930.24
Other Income		935.64
		723,865.88
Other Charges - Interest on notes		86,359.02
Profit before provision for depreciation, depletion and loss on disposal of equipment		637,506.86
Deduct:		
Depreciation	18,869.70	
Depletion	498,057.96	
Loss on disposal of equipment	4,349.01	521,276.67
Profit before Provision for United States Taxes on Income		116,230.19
United States Taxes on Income		31,500.00
Net Earnings		84,730.19
Earnings Retained in the Business - Balance, December 31, 1953		165,832.92
Earnings Retained in the Business - Balance, December 31, 1954 (Note C)		$250,563.11